IRAN'S POLITICAL ECONOMY SINCE THE REVOLUTION

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Iran's Political Economy since the Revolution

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the speaker of the parliament, in an address given on the floor of the parliament. He was rebuked by no less than Chief of the General Staff of the Armed Forces of Iran General Seyyed Hassan Firouzabadi for "unacceptable" allegations against the system. As his second term drew near a conclusion, the president traded jabs with a variety of his adversaries in the parliament and other official institutions, clearly itching for an opportunity to release publicly a list of 312 individuals for whom he claimed to have evidence of official malfeasance.

For the president's critics, all of these scandals were part of a seamless pattern of misdeeds by Ahmadinejad. The former aide to the president Ali Samari argued that the network of Ahmadinejad cronies taking advantage of the system had

> become like a cancerous tumor attacking the health of the public treasury.... The only justification for this fraud is that the top echelons were involved in it. The deviated group has turned the banking system into its own backyard, and all their economic efforts are in line with this attempt. The problems of the Oil Ministry leading to the dismissal of the minister, the problems of the Intelligence Ministry and the president boycotting his office for 11 days, the issues of Kish Island and incomplete projects, Qeshm tenders, airline programs, the tourism organization's financial problems, and the wandering funds of the Council of Iranians Abroad are all proof of this claim.[136]

For his part, Ahmadinejad continued to insist on the purity of his presidency, arguing in fact that it was his very diligence in pursuing corruption cases that had produced such an onslaught of criticism, including allegations of financial misdeeds, against his administration. "I am stressing again that I am the only president who has announced that if anyone sees an offence committed by me or those related or affiliated to me should report it to the Judiciary to be dealt with according to the law," Ahmadinejad declared in a June 2011 news conference, adding "maybe the reason that we are receiving so much pressure is because we are insisting on our position."[137]

IRONIES OF THE AHMADINEJAD ERA

Ahmadinejad's divisive disposition, his repressive predisposition, and the contentious history that led him to and kept him in power have fixed him

[136] "Embezzlement and Economic Corruption in Free Zones Go Back to People Close to the President," *Qods*, September 21, 2011.

[137] News conference by Iranian President Mahmud Ahmadinezhad with foreign and domestic correspondents in Tehran; broadcast in progress by Islamic Republic of Iran News Network Television (IRINN), June 9, 2011, from World News Connection.

firmly in the role of a buffoonish nemesis to the democratic aspirations and institutions that remain just under the surface of the Islamic Republic. And yet at least some of the Ahmadinejad experience would ring frustratingly familiar to a partisan of Khatami or the reform movement more broadly. Despite his own authoritarian instincts, Ahmadinejad found himself perennially outmanned in the turf battles that define the day-to-day politics of revolutionary Iran. "An institution which is outside the authority of the president and the ministers should not get a budget from Majlis," the president argued in a speech to the Majlis. "These institutions should implement the government's and Majlis decisions. I don't want to mention everything, but there are right now, some institutions or organisations which receive a budget but go exactly the opposite directions of what the government had decided, while the president or a minister is responsible for their actions."[138]

Ahmadinejad's criticisms of the reliance on central planning and the obscurities of the budget process that have facilitated parliamentary horse trading are not necessarily inappropriate critiques, even if they are partisan in genesis. Instead, he argued, "the budget bill should be understandable for anyone knowing to read and write" and lamented that "the [state] treasury has become a source from which everyone with a hose can have an item number and pump out the budget."[139] The budget battles between Ahmadinejad and the parliament provided a proxy for a large struggle over institutional authority in the Islamic Republic. In this respect, Ahmadinejad's efforts were not dissimilar to those of Khatami, who repeatedly sought to expand the powers of the presidency to no avail.

CONCLUSION

The turning of the tides of Iran's turbulent politics did not appear to demoralize Ahmadinejad. All the characteristics of his early ascendance and his brutal reelection victory – the pugnacious self-confidence, the mastery of minutiae, the proclivity for surprise attacks on political adversaries, and, most of all, his absolute conviction in his own righteousness – remained fully intact in his public persona. The sanctions provided a useful scapegoat for any perception of error or disappointment in his agenda and appeared to have only stiffened the embattled president's spine, at least insofar as his economic policies were concerned. Asked in

138 Saba Azarpeyk, "The Simple Budget in Parliament," *Etemad*, January 12, 2008.
139 *Ibid.*

8

Energy and the Islamic Republic

In March 1979, when Iran's nascent Islamic Republic resumed crude oil exports after sixty-nine days of revolutionary disruptions, it seemed to herald a new era. Iranian oil workers had played a central role in driving the shah from the throne, and issues related to Iran's oil sector had mobilized Iranian oppositionists for nearly half a century. A government established through popular action now had not simply authority over the formidable instruments of state power, but also – for the first time in Iran's history – unqualified authority over the country's foremost asset, its petroleum endowments.

From its outset, the Islamic Republic realized the objective that had eluded the determined efforts of Reza Shah, Mosaddeq, and Mohammad Reza himself. At the ceremony that marked the resumption of exports, Hassan Nazih, a human rights lawyer who initially led the postrevolutionary national oil company, became emotional at the revolution's early achievement. "This is the greatest moment of my life.... I hope it is an omen of a bright future for our country and our people."[1] Unfortunately, Nazih's optimism proved premature. He was quickly purged for ideological differences, and the new state's sway over the country's incredible resources has not translated into the propitious future that he envisioned. Instead, Iran's oil production has never returned to its prerevolutionary heights, and the sector has been battered by government policy, sanctions, war, and political risk.

[1] "Oil Flow from Iran Resumes; First Two Tankers Get Loads Priced at $20 a Barrel," *New York Times*, March 6, 1979.

The energy sector is ground zero for all of the revolutionary state's dilemmas. It represents the wellspring of modern nationalism and continues to generate the bulk of Iran's foreign exchange, as well as its access to and prominence within the global economy. The Islamic Republic's founders sought to reconfigure the role of energy in the postrevolutionary economy, so that the country's new authorities maintained a decisive upper hand over the international oil companies, as proxies for Western power, and the sector's revenues were used to advance Islamic values and sustainable growth, rather than exploitation, immorality, and the monarchy's apish ambitions.

The outcome has proven far more murky. The energy sector offered both the vehicle and the vulnerability for the persistent struggle between Iran and its neighbors for regional domination. After the war, Tehran's efforts to use oil as a pathway to diplomatic redemption and economic rehabilitation became mired with political debates over shielding its patrimony from foreign rapacity and eventually with fallout from the nuclear standoff. And while Iran's oil revenues have surely funded infrastructure development, they have sustained the same rentier patterns and mundane impulses that undermined the shah. Corruption and cronyism thrive as the Islamic Republic's feuding factions vie for their share of the bounty – even as the same politicians continue to rely on populist rhetoric to bolster public support for the regime.

As a result, Iran's energy development, like so much else in the country's contemporary experience, is profoundly paradoxical. Ultimately, Iran's ties to the energy industry have gradually facilitated the partial rationalization of its postrevolutionary political economy. Since 1979, Iranian energy policy has been driven less by ideological imperatives than by the inescapable need of the postrevolutionary state for revenues to meet popular expectations to have the oil money on their tablecloths, as Ahmadinejad so memorably argued in his 2005 presidential campaign. However, the legacy of Iran's contentious history with international oil companies and Western governments remains firmly entrenched. Perhaps uniquely in the modern era, the Islamic Republic has attempted to balance a central place in the global economy with fierce ideological hostility to the most important factor in those markets. And nowhere has that contradiction played out more dramatically than in the energy sector.

PREREVOLUTIONARY PETROLEUM SECTOR

For Mohammad Reza Shah, control over Iran's oil resources – and the corresponding revenues – was the sine qua non of regime power, internal

stability, and international clout. If he did not absorb that lesson from his father's bitter failure to renegotiate the Anglo-Persian concession, it was surely thrust upon him during the nationalization campaign and the rapid denouement of Mosaddeq's domestic power base during the British embargo. With the memory of these skirmishes looming large and the prospective upside from any improvement in the government's terms seemingly boundless, energy was naturally a central preoccupation.

The shah devoted considerable energy to mastering the workings of the oil markets and the requirements of Iran's resource base. "I know everything there is to know about oil, everything," the shah boasted to a reporter in the midst of the dramatic 1973 oil price spike.[2] He was buttressed by talented technocrats within the executive branch and NIOC. However, their hard-won education into the industry's financial and technical aspects could not dissuade the shah of the belief that the international oil companies and Western governments had ill used Iran. He was determined to redress the imbalance in influence and economic returns, and in contrast to his ambivalence toward nationalization a generation earlier, he was fully prepared to play hardball to achieve this.

The shah invested enormous energies in wresting control of production and price decisions from the consortium and in carving out production deals outside the consortium territory. And despite some initial skepticism toward OPEC, the shah also came to appreciate the additional clout that the nascent producers' cartel afforded. The monarchical obsession with energy served both the shah's domestic motivations and foreign policy ambitions. Oil revenues fueled development programs that the shah saw as essential to his own legitimacy and to the required betterment of the nation. And for the first time, the gas that had long been flared would be utilized to jump-start the country's industrial development. But energy was also integral to his view of Iran's place in the world – no longer a supplicant to world powers or subjugated by their machinations, but the architect of its own future. "No one can dictate to us," the shah declared in 1974. "No one can wave a finger at us, because we will wave a finger back."[3] This vision of oil as a vehicle to move the country from exploited to empowered persisted long after the monarchy expired.

[2] William D. Smith, "Oil Watchers Focus on Shah of Iran," *New York Times*, March 7, 1974, p. 55.

[3] "Shah Rejects Bid by Ford for Cut in Prices of Oil," *New York Times*, September 27, 1974.

The shah himself played a dominant role – the "pivot in the price hike," as one memoir describes him – in the epic reconfiguration of the international energy business.[4] He personally engineered OPEC's successful push for higher prices and greater host government control over operations and exports. This initially provoked a muted competition with the Saudis, who sought a less provocative approach. The rivalry between the two Gulf heavyweights, with very different fiscal exigencies and popular mandates, persisted and mutated over the next four decades in ways that would prove deeply problematic for successive Iranian governments.[5]

In the early 1970s, the Pahlavi dynasty appeared to hold the advantage. The shah's success in seizing control of the concession's operations and simultaneously escalating global prices reaped fantastic benefits for Iran and ratcheted production to historic levels. Over the dozen years prior to the revolution, Iran's output increased an average of 8.7 percent per year, expanding from slightly more than 1.9 mbpd in 1965 to 5.3 mbpd in 1978, with a high of more than 6 mbpd in 1974.[6] Iran would never again attain those epic production rates.

Much as his successors used oil exports and investments to cement their influence, the monarchy used nascent command of energy to extend its diplomatic reach. After successfully brokering the 1971 concession renegotiation, the shah described his achievement as "the oil problem solved, rain for our crops and Iran's leadership of the whole Middle East acknowledged throughout the world."[7] Washington always figured front and center, and his Midas touch meant access to the most advanced technology and defense capabilities. He used Iran's newfound wealth and weaponry to assert himself across the region – in Iraq, Oman, and a scattering of Gulf islands – and to embark on a less clientelistic relationship with the United States.

Iran's oil connections under the shah extended to its robust relationship with Israel, which relied on Iran for as much as 75 percent of its

[4] Afkhami (2009), p. 278.

[5] See Andrew Scott Cooper, *The Oil Kings: How the U.S., Iran, and Saudi Arabia Changed the Balance of Power in the Middle East* (New York: Simon & Schuster, 2011) for a dramatic interpretation of the 1970s interplay among the shah, the Saudis, and the U.S. government over oil prices and military sales.

[6] Data from *BP Statistical Review*, 2011.

[7] James Buchan, *Days of God: The Revolution in Iran and Its Consequences* (London: John Murray, 2013), p. 169.

development of local spur lines for gas-fired industrial development including a cement plant in Shiraz. Additional gas export projects were in the works at the time of the revolution, including a second trunkline intended to deliver gas to Europe via swaps with Moscow. At the same time, Tehran was pressing liquefied natural gas (LNG) export plans with Japanese, European, and American companies. In 1978, two U.S. firms sought U.S. Department of Energy approval of 300 million cubic feet (mcf)/day in LNG imports from Iran.[11]

The shah's energy strategy entailed considerable risk and contradiction. His crusade against the companies unnerved his advisers, who remembered the consequences of prior battles with the companies and the world powers who relied upon their stable supply of energy. He walked a fine line with his neighbors and fellow OPEC heavyweights by opting out of the Arab oil boycott but utilizing the episode to expand Iran's market share and cement its alliance with Washington without significant cost. After his successes in leveraging greater control and revenues from the Western companies in the early 1970s, the shah struggled and ultimately failed to achieve rising prices and revenues in the second half of the decade. This period marked the apex of Saudi dominance of oil markets and OPEC and exacerbated Iran's overheated economy at a critical turning point.

POSTREVOLUTIONARY PETROLEUM SECTOR: INSTITUTIONAL AND LEGAL FRAMEWORK

The revolution, and the accompanying chaos, changed everything, or so it seemed. Oil worker strikes through late 1978 devastated the monarchy, and the disarray was prolonged by the departure of thousands of technocrats, the ongoing divisions among the revolutionaries, the perpetuation of worker activism and ethnic unrest, and the Iraqi invasion, which massively impacted energy-related facilities and transportation. Compounding these oil disruptions were the new regime's political imperatives. Initially, the revolutionary leadership was split over management of Iran's oil resources and sector. The legacy of 1953 meant resource nationalism was an integral dimension of revolutionary ideology, and the conviction that Iran's patrimony had been squandered by the shah and exploited by the West was shared across the political spectrum. However,

[11] "Two Utilities Seek Iranian Gas," *New York Times*, June 28, 1978, p. D11.

creation nudges the Iranian oil sector toward greater rationalization; however, it has succeeded only marginally in shifting policy making away from the company and toward the political establishment. Episodic attempts to reform the sector in order to establish greater accountability have run aground.

This deficiency left a vacuum that the parliament was eager to fill. Parliamentary activism dates back to nationalization and its role in shaping the national budget and international agreements. As a result, the parliament has often proved interventionist. However, under the Islamic Republic, the relationship between the Majlis and the Oil Ministry as well as with NIOC and its affiliates served as a proxy for Iran's broader factional competition within the political establishment. At times, the parliament has vigorously asserted itself on energy policy issues in an effort to champion its institutional dominance vis-à-vis the executive branch, and in hopes of weakening individual technocrats – such as Bijan Namdar Zanganeh – perceived as exceeding their deliberately constrained authority. During other periods, however, the ministry has managed to co-opt the parliament, as in the 2012 election to a seat of the former oil minister Masoud Mirkazemi, whose tenure as chair of the Majlis Energy Commission proved notably lenient toward his successor – perhaps in part because of opportunistic placement of former commission members in NIOC subsidiaries.[17]

The ideological opposition to foreign companies and constitutional restrictions on ownership, combined with an adverse environment for foreign investment, count among the sector's major challenges. However, the Islamic Republic has confronted an array of more prosaic obstacles in its energy development. One of these has been the failure to establish organizational coherence and clear lines of authority. Although oil production has never reached prerevolutionary heights, employment within the industry itself ballooned. This expansion initially compensated for the departure of foreign oil experts and workers. Exploration and development remain under NIOC auspices, with subsidiary Pars Oil and Gas charged with the largest gas fields including the epic South Pars gas field, and other geographically delimited subsidiaries that oversee development of the various other fields. In parallel with opening the hydrocarbons sector to foreign investment, an array of spin-off companies were established to manage specific projects.

[17] Yong and Hajihosseini (January 2013).

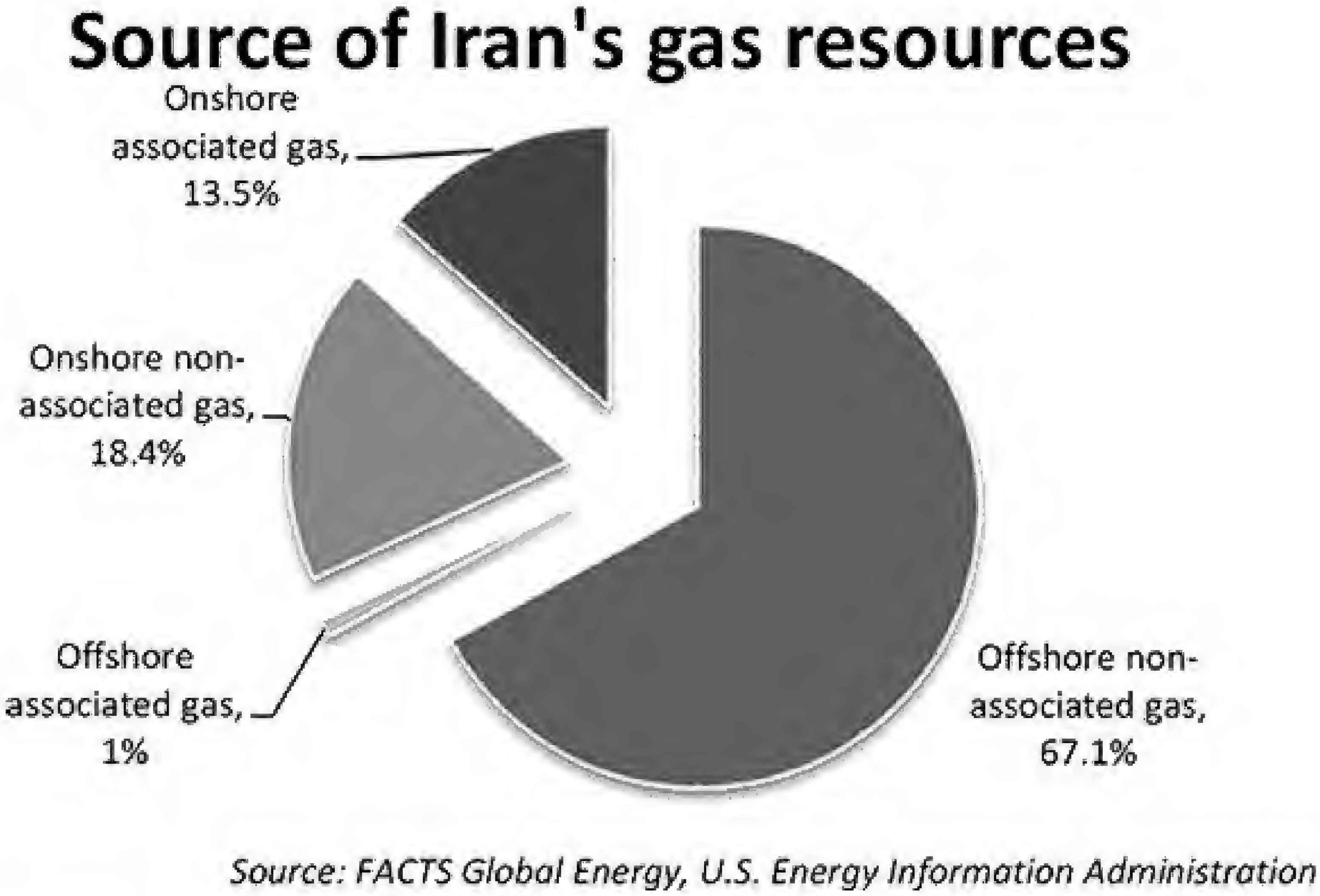

FIGURE 8.2. Source of Iran's Gas Resource

new year.[18] In 2000, his successor made the same promise,[19] and similar boasts continued throughout the subsequent decade. Yet the failures to meet these unrealistic expectations of the industry's proponents should not mask NIOC's underlying achievements. Despite heavy political constraints and severe restrictions in its access to foreign technology, expertise, and capital, Iran has managed steadily to increase its oil production capabilities, reaching a postrevolutionary high in 2008 of 4.184 mbpd.[20]

Notably, despite other energy struggles, the Islamic Republic can claim something of an energy success story in the explosion of gas production and consumption. Although overall energy production has declined since the revolution, the past three decades have witnessed a dramatic upsurge in annual gas production of more than 670 percent, from approximately 1.6 bcf/day in 1979 – and this was a reversal of the previous four years of declining production – to 13.4 bcf/day in 2010.[21] As Figure 8.2 indicates, more than two-thirds of Iran's proven gas reserves lie in offshore,

[18] Youssef M. Ibrahim, "Pumping Oil: Iran's New Muscle; Rebounding Iranians Are Striving for Regional Leadership in Gulf," *New York Times*, November 7, 1992.

[19] "Oil Production in Iran to Reach 5 mn bpd in Five Years to Come," *AZER Press*, July 18, 2000.

[20] *MEES*, November 2, 2008.

[21] These are estimates; figures from *BP Statistical Review* 2011

nonassociated fields, and their development has necessitated massive new investments in infrastructure and technical capabilities.

OIL AND THE NEW ORDER

The postrevolutionary government focused on diversifying the economy and attenuating its integration in the international energy business, which its leaders saw as draining Iran's patrimony and subjugating the country to Western capitalist interests. For the first several years after the revolution, the Oil Ministry held that "oil should be used as a political and economic weapon."[22] There was a broad consensus that a more diversified economy, oriented to the interests of the Iranian people rather than Western consumers, would place less emphasis on petroleum and the quick accumulation of wealth. Still, from the start, Khomeini appreciated the leverage offered by Iran's oil production; during the height of the Kurdish rebellion, for example, he announced that he had ordered NIOC to put a single day's oil receipts for development projects in Iran's Kurdish provinces as a means of acknowledging and, at least nominally, assuaging local grievances.

Husayn Nazih, the human rights lawyer initially tapped to head NIOC, quickly found himself in an impossible situation – trying to revive production, deal with sabotage and terrorism, assuage political sensitivities as well as labor grievances, mitigate the loss of some six hundred foreign experts, and manage a sector that he knew only superficially, all in the midst of profound political infighting. He was quickly overcome by revolutionary turmoil, and after a brief but abortive bid for the Assembly of Experts, Nazih fled to France over feared backlash from revelations that emerged as a result of the embassy seizure of his meetings with U.S. diplomats.

Nazih was replaced by Ali Akbar Moinfar, another left-leaning technocrat, who still had the Islamists' confidence. The new leadership announced its readiness to revive production and maintain export relationships with the former consortium companies. To some surprise, Tehran was able to command a premium for its initial postrevolutionary spot sales. Other than demands to preclude reexport of Iranian crude to Israel and South Africa, the new regime's early crude deals hewed closely to the country's prior trade patterns: Most of Iran's crude remained destined for Europe and Japan. Tehran did abandon several prerevolutionary joint ventures, including refining deals with South Africa and South Korea.

22 "Iran to Use Oil Meeting to Seek Aide's Release," *Reuters*, December 13, 1979.

The structure of oil contracts and the psychological impact of the revolution had precipitated another sudden and severe price spiral.[23] During the hostage crisis, Tehran appealed – futilely – to fellow OPEC members to limit their own production in sympathy with its "antiimperialist struggle."[24] Iran also sought to shift away from requiring dollars in its export transactions and embargoed oil sales to U.S. companies. These measures did not significantly disrupt oil markets, which were already in turmoil from prerevolutionary panic and price escalation. However, they "amplified the overall nervousness and anxiety in the market" and ultimately enabled Tehran to ratchet prices and revenues upward.[25]

However, by mid-1980, the price hikes associated with revolutionary upheaval were already beginning to abate. In April 1980, Japan rejected Iranian price demands, instead expanding their imports from Saudi Arabia and the UAE. Other IOCs, including BP and Shell, also began to balk at Iranian demands. The pricing dispute coincided with new Japanese and European sanctions on Iran over the hostage crisis. Tehran brushed off the dispute, with Moinfar questioning, "What would be the use in trying to produce more when we have no use for the money? We are not interested in piling up dollars in foreign banks and then having no use for them."[26] Already, though, the lure of oil rents split the new leadership, with Prime Minister Rejai arguing to expand production during debates over the 1981 budget. The breach with Tokyo lasted ten months until a new agreement allowed Japanese imports to resume at 170,000–180,000 bpd.

THE WAR AND IRAN'S ENERGY SECTOR

With the September 1980 Iraqi invasion, revenue requirements began to force the rapid reconstitution of an industry that had been battered by pre- and postrevolutionary turbulence. The war threatened the permanent loss of production from Khuzestan to Iraq's voracious appetites. Taha Ramadan, Iraqi vice president, declared that Iran's oil production or, as he put it, "Arabistan's oil will be Iraqi as long as Tehran will not negotiate."[27]

[23] Yergin (1991), pp. 684–8.
[24] "Iran Asks Other OPEC Members to Limit Oil Output Next Year," *Wall Street Journal*, December 3, 1979.
[25] Yergin (1991), p. 702.
[26] "Iran Reports Big Oil-Income Loss," *New York Times*, June 13, 1980.
[27] "Iraqi Aide Says Aim Is to Seize Iran's Oil and Then Negotiate," *New York Times*, October 22, 1980, p. A1.

One of the initial Iraqi offensives near Abadan captured the acting oil minister; the next permanent minister, Mohammed Gharazi, gave to the post an industry background as well as impeccable revolutionary credentials that included stints in the shah's prisons as well as Najaf and French exiles. Gharazi helped to found the Revolutionary Guard Corps and served as deputy governor of Khuzestan, where he won plaudits for uncovering and viciously repressing an alleged plot against local military forces. He maintained his office in central Ahwaz even after the Iraqi incursion, declaring that "if Iraqi MiGs attack the city and hit this building, I will be the first to die."[28] Gharazi was influential enough within the early postrevolutionary power structure that in 1981, Khamenei pressed for him as prime minister after the president's first choice – Ali Akbar Velayati, who went on to serve instead as foreign minister – was rejected by the parliament on the basis of insufficient revolutionary credentials. Gharazi's nomination was also quashed, a move that paved the way for a government led by Mir Husayn Musavi.

The war devastated Iran's petroleum sector, in both direct and indirect fashion. The conflict destroyed vital facilities, including the Abadan refinery, and Iran's main oil export terminal was also targeted repeatedly. During the revolution's first decade, Tehran struggled to revive production and maintain exports as its facilities and transportation corridors were bombed and its economy was subsumed by both sanctions and war mobilization. Overall trends were intensely negative – from an average production level of 3.17 mpbd in 1979, despite massive unrest and labor actions in the oil sector, average production fell to 1.5 mpbd as a result of the Iraqi invasion the subsequent year.[29]

The same problems that plagued Iran's military resupply – sanctions, foreign exchange shortages, and a profound lack of either credit or credibility – hurt Tehran's ability to revive oil production. The war also exacerbated Iran's weak position within OPEC. After the revolution, Tehran lost its opportunity for an OPEC leadership role, and Saudi Arabia responded to the Iraqi invasion by ramping up production and filling the supply breach for a dozen countries. Tehran repeatedly pressed for a higher OPEC quota, based on the exigencies of war: "We have a series of expenses the others do not have," argued Gharazi.[30]

[28] Richard Johns and Terry Povey, "Opec's Most Political Animal," *FT*, January 29, 1983, p. 34.
[29] Salehi-Isfahani in Rahnema and Behdad (1995), p. 153.
[30] James Crawford, "Yamani Sees Hope of Oil-Sharing Pact," *Globe and Mail*, December 20, 1982.

Still, over the first half of 1982, in part out of a desperate need for hard currency revenues, Tehran made major strides in reviving production and putting damaged facilities back on line. Iranian exports expanded from 400,000 bpd in early 1982 to 2 million bpd six months later. At the same time, Tehran sought to improve its position within OPEC, in hopes of shifting its competitors' production policies in its own favor. Iranian representatives advocated quotas based on each state's population and financial requirements. The Iranian oil minister Mohammad Gharazi invoked a Persian proverb in making the case that "those who have more roof gather more snow."[31] When that gambit failed, Tehran sought to grab market share and expand its revenue base by instituting price cuts that defied the cartel's agreed price band, risking an open breach with OPEC. At a 1983 ministerial meeting, Gharazi declared that "every reduction in Saudi production that is added to ours means a victory."[32]

Despite struggles in maintaining production and achieving needed revenues, the Iranian leadership sought to use oil trade as a political weapon. In 1983, after a French sale of advanced strike jets equipped with Exocet missiles to Baghdad, Tehran threatened to blockade all Gulf exports by threatening safe passage through the Straits of Hormuz. Rafsanjani predicted that if the sale went through, the West "would face a very cold winter."[33] However, when the inevitable occurred – an Iraqi attack on tankers at Iran's main export terminal, Kharg Island – Tehran hunkered down. The relative imbalance in the two combatants' dependency on oil revenues limited Tehran's options, since it had almost no recourse to compensate for lost export opportunities while Baghdad had an array of deep-pocketed supporters.

As discussed in Chapter 4, the Saudis engineered the mid-1980s collapse of oil prices, which fortuitously undermined the Iranian economy and by extension Iran's war prospects. Later, when the "tanker war" phase of the conflict escalated to direct skirmishes between Iranian and American naval forces, Tehran faced prolonged risks in its traditional Gulf export routes, and in 1987 Iran's oil minister launched talks with

[31] Milton Freudenheim and Henry Giniger, "Knocks, Pings at OPEC Session," *New York Times*, December 26, 1982.

[32] William Drozdiak, "OPEC Output Pact Collapses; Yamani Hints at Price Cut," Washington Post, January 24, 1983, p. A1.

[33] Thomas Lueck, "Iran-Iraq Oil Threat Minimized," *New York Times*, October 17, 1983.

expanded from 11 bcm in 1985 to 18 bcm in 1989.[39] Still, flaring continued in significant volumes; in 2008, the World Bank ranked Iran the third leading source of flared gas, at an estimated 10 bcm per year.[40]

Despite rising production, gas exports did not factor high on the postrevolutionary energy agenda. In the months before the revolution, labor unrest disrupted gas exports to the Soviet Union, and the successor regime ultimately cancelled all other gas export projects as part of its broad repeal of monarchical-era energy contracts. Although Tehran grudgingly relaxed its opposition to foreign investment in oil and gas, particularly after the war's end, the consequences of its gas export cancellations should not be underestimated. The rescission of Iran's burgeoning gas exports had long-term consequences for the country's place in the global economy; had IGAT II moved forward as initially intended, it would have been "the biggest gas corridor in the world after the Soviet Union's."[41] Instead, gas exports to the Soviet Union tapered off after the Iraqi invasion, with Tehran diverting supplies for domestic consumption while demanding higher prices from Moscow. Meanwhile, other competitors – particularly Qatar, whose massive gas field is part of the same geological structure as South Pars – found an open field as the international gas trade began to boom.

Even in the Islamic Republic's early years, the revolutionaries did not close the door entirely to foreign presence in the energy sector. At this same time, Iran began exploring possibilities for a return by international oil companies, despite the constitutional prohibitions on foreign ownership. In late 1981, Iran contracted for technical assistance with Romania to rebuild facilities damaged by the war.[42] In 1982, Tehran began working with Agip to extend pipelines from the Kangan gas field.[43] That same year, Tehran signed a memorandum of understanding with Ankara for a feasibility study to examine the prospects for constructing a pipeline via Turkey to transport Iranian gas to Europe.

One of the casualties of the war was a long-delayed petrochemical plant at Bandar Khomeini (Shahpour prior to the revolution); after repeated setbacks and price escalations, the complex was nearing completion at the time of the revolution. Despite revolutionary disruptions,

[39] Ibid.
[40] "Natural Gas Liquids Supply Outlook 2008–2015," International Energy Agency, 2008, p. 23, http://www.iea.org/textbase/nppdf/free/2010/NGL2010.pdf
[41] Afkhami (2009), p. 341.
[42] "Iran Embargo Just Partial Success," *Reuters*, November 16, 1981.
[43] "Iranians Challenge Oil Limits," *New York Times*, November 8, 1982.

next several years, NIOC undertook talks with a range of prospective partners over an array of oil and gas projects, including Total, Chevron, Agip SpA, Japan National Oil Company, British Petroleum, and the Soviet Machinoexport.

At the time, the focus on South Pars was something of "a surprise" to external analysts given Iran's fiscal vulnerabilities and the sufficiency of its existing gas developments. In the late 1980s, Iran had initially explored the possibility of jointly developing the resource with Qatar. Qatar's September 1991 launch of North Field developments drew international headlines and capital, and until the scope of the Iranian structure was better understood, there was a presumption among many in the industry that Tehran was simply seeking to shake down its Gulf neighbor.[49]

Despite its mammoth reserves, South Pars development has proven prone to complications since its outset. In 1993, Tehran revoked a $1.7 billion contract issued to Italian, Japanese, and Russian firms the previous year, after the government's external debt load imperiled prospects for European financing. At the same time, the collapse of the Soviet Union and changes under way across Eastern Europe unexpectedly eliminated Iran's sole gas export relationship, which had only just been painstakingly reconstructed after a decade of inactivity. The situation soured some Iranians on the hard-fought opening to foreign investors; in the words of one official at the time, "if foreign companies want to be active in the oil sector, they'd better change their terms and make them less demanding."[50]

After the rescission of the Italian/Japanese/Russian deal, an NIOC spin-off firm, Petroleum Development and Engineering Company (Pedec), took over in 1994. Pedec's difficulties in attracting financing meant that little progress was made until the project was shifted once again to the newly established Petropars in 1998. During the same period, in a flurry of negotiations with a wide array of European and Japanese firms, Tehran pushed forward the development of subsequent South Pars phases. In 1997, a consortium that comprised Total (France), Gazprom (Russia), and Petronas (Malaysia) agreed to develop Phases 2 and 3, with Hyundai (South Korea) serving as the primary subcontractor for onshore construction.

[49] "Saipem and TPL Near Accord on South Pars Field," *MEED*, July 26, 1991.

[50] Randall Palmer, "Iran Snubs Foreign Firms in Oil/Gas Contracts," *Reuters*, August 31, 1994.

themselves enmeshed in costly corruption scandals that damaged both their profile within Iran as well as their international reputation.[53] Increasingly, as international sanctions intensified, new project tenders were subject to repeated delays and revisions, and new opportunities began to present themselves, as in Iraq and Libya, the enthusiasm of the international oil companies for Iran began to wane.

In 1989, Tehran and Moscow agreed to revive the IGAT I export swaps and negotiated similar deals with Bulgaria, Romania, and Yugoslavia, as well as talks with Czechoslovakia, Poland, and Greece. Those deals collapsed with the demise of the Soviet Union and the Eastern bloc, raising questions about the markets for South Pars production. "Just as it seemed the long-planned but seemingly fated plan to export to Europe via Turkey was entering the home straight, someone shifted the entire track."[54] The loss of the Soviet market for major infrastructure projects – Moscow had helped finance several major dams as lower costs than other bidders – helped drive Iran's decision to open the energy sector, and the broader economy, to investment from Western Europe, Japan, and even America.

Alongside the initiative to develop South Pars, Iran has sought to revive other gas export possibilities, including pipeline and LNG deals that echoed the prerevolutionary plans. In 1993, Tehran signed a preliminary agreement with Gaz de France for feasibility studies into various pipeline and LNG export options. At the time, the Petroleum Ministry envisioned exports of approximately 50 bcf/year by 2000, half of which was intended for European and Pakistani markets.[55] In 2001, Oil Ministry officials projected that gas export revenues would gradually rise to levels commensurate with historic patterns, predicting $6 billion from South Pars alone.[56]

These projections proved overly optimistic. Tehran's export capabilities have been constrained by a variety of forces: domestic mismanagement and volatility in the petroleum sector, sanctions-imposed limitations on access to technology and capital, and fierce rivalries over establishing dominant export corridors from competitors including Qatar, Russia,

[53] Both Total and Statoil were alleged to have paid bribes as a means of securing and maintaining their stakes in South Pars. "Total Takes $390 Mil Settlement Provision over US Probes of Iranian Gas Deals," *Platts*, July 27, 2012.

[54] "Events Buffet Iran's Export Plans," International Gas Report, *FT*, January 10, 1992.

[55] "Making the Most of Oil," *MEED*, October 18, 1991.

[56] "Special Report Oil & Gas – Pars Oil & Gas," *MEED Weekly Special Report*, March 23, 2001.

and the Central Asian states, the latter the recipients of substantial U.S. government backing. Still, Iran managed to achieve modest export levels to Armenia and Turkey via pipeline and arranged two separate swap arrangements with Azerbaijan, one of which provides Iranian gas to the Azeri enclave of Nakhchivan.

Turkey remains the longest-standing of Iran's export relationships, and its chaotic history speaks to Iran's challenges in positioning itself as a reliable gas source. Talks between Tehran and Ankara began shortly after the revolution and culminated in 1982 in a gas export deal.[57] However, a supply agreement was not signed until 1996, and sanctions and financial issues further delayed the launch. The pipeline linking Tabriz to Ankara was completed in 2001 with a capacity of 28 Mcm/day.

Shortly after its initial foray into IOC investment went awry in South Pars, Tehran extended the buyback model to upstream oil, only to face similar obstacles. In 1994, an Iranian spin-off company, IOEC, sought foreign partners in developing the Abuzar oil field, but an American, French, and Japanese consortium failed to raise sufficient funds.[58] Once again, financing problems and the aftereffects of the debt crisis thwarted a politically sensitive international deal. Still, despite these stumbles, Iranian officials perceived themselves in the driver's seat as they sought foreign investment in the upstream. "If foreign companies want to be active in the oil sector, they'd better change their terms and make them less demanding."[59]

This backdrop helps to explain why Conoco won Iran's first postrevolutionary upstream oil contract awarded to a foreign firm. Prior to 1995, ideological preferences and factional infighting deterred Tehran from serious pursuit of American firms for exploration and development openings. However, the difficulties in securing financing for South Pars Phase 1 and Abuzar commended consideration of a more influential partner – one that might overcome official U.S. opposition and financing restrictions. In March 1995, Tehran announced Conoco's selection to lead development of the Sirri A and E offshore oil fields – a deal estimated to be worth $1 billion and one in which the French firm Total was perceived as the favorite.

57 "Iran Agrees to Supply Natural Gas to Turkey," *New York Times*, September 11, 1982.

58 "Local Firms Given Lead in Oil and Gas Schemes," *MEED*, September 5, 1994.

59 Randall Palmer, "Iran Snubs Foreign Firms in Oil/Gas Contracts," *Reuters*, August 31, 1994.

The decision generated a fierce backlash. Although Conoco officials had invested heavily in their bid, the public outcry in the United States quickly persuaded the company to back away even before Washington issued its formal ban on oil investments a few weeks later. The project reverted to Tehran, where initial frustration and concerns quickly gave way to renewed interest from multiple European firms. Still, the unsettled political environment had shifted the commercial context, and ultimately Shell dropped out of the bidding. Total went on to develop the Sirri fields in Conoco's place and shortly thereafter assumed a major role in the first round of South Pars exploration and production contracts that went to foreign firms.

Iranian officials scrambled to shift gears, depicting the episode as an important triumph in their efforts to parry American efforts to isolate the country. After the Total deal, Tehran was almost giddy with expectation; Iran's deputy oil minister announced that twelve projects, worth a total of $6.5 billion, would be tendered to international companies.[60] "We have an excellent response from the industry, it's outstanding.... I don't anticipate any problem at all," Bonakdar Hashemi, NIOC's deputy general manager for overseas participation and international agreements, declared in 1995.[61]

During this period, Tehran also sought to leverage its strategic location to serve as a hub for Central Asian oil and gas exports, offering landlocked Caspian states a route for getting their production to market and enabling Iran itself to optimize its domestic energy balance. Consistent with efforts to isolate the Islamic Republic, Washington countered, devoting considerable resources and effort over the course the 1990s and beyond to the promotion of alternative pipeline routes. To the extent that the U.S. strategy succeeded, it was aided by market forces. With the establishment of new pipeline systems with its neighbors largely precluded by U.S. sanctions, Tehran was forced to rely on oil swaps, which offered only marginal revenues and cut into the country's OPEC quota. An Iranian MP revealed that Iran's total revenues over nine years of swaps totaled a mere $146 million, and when swaps were abandoned in 2010, then–Oil Minister Massoud Mir-Kazemi described them as "completely disadvantageous for us."[62]

[60] "Iran to Offer 12 Oil Projects to Foreign Firms," *Reuters*, July 27, 1995.
[61] "Iran's NIOC Upbeat over Energy Projects Tender," *Reuters*, September 7, 1995.
[62] Ebrahim Gilani, "Iran's Decision to End Loss Making Oil Swaps Could Reduce Its Influence in the Caspian Region," Institute for War and Peace Reporting, October 7, 2010.

THE SPIN-OFF COMPANIES

The opening of Iran's petroleum sector to foreign companies prompted the establishment of new entities to handle specific projects and/or tasks, often with little or no real supervision by the state. Many of these were created as semiprivate entities. In addition, there are a range of additional direct and indirect (semiprivate) subsidiaries performing as subcontracted developers of the fields, in cooperation with international and foreign national oil companies in some cases. The proliferation of these companies began during the Rafsanjani presidency but reached its peak during Khatami's tenure. At least one hundred "affiliated and subsidiary companies" have staked a claim in one or more of Iran's current and future upstream projects.[69]

The NIOC spin-off companies have their roots in the distribution of the spoils. They operate with a larger degree of autonomy than NIOC and its immediate subsidiaries, but they are and always have been directly controlled by the government and fully publicly capitalized. Not surprisingly, authority over South Pars has been the subject of persistent turf battles; the multiplicity of cutouts ultimately reflects countervailing impulses toward distribution of the spoils and periodic efforts at rationalization and promotion of competition.

One of the largest of these is Petropars, which is engaged in South Pars Phases 1, 4 and 5, 6 through 8, 12, and 19. Petropars was established in 1997 as an offshore company, registered in the Virgin Islands, to manage South Pars projects. Its original shareholders were the NIOC Pension Fund (60 percent) and the Industrial Development and Renovation Organization Pension Fund (40 percent). As with other aspects of Iran's economy, its origins reflect a short-term fix to long-term problems; its leadership argued that "the services we need are not available in our banking system, or our insurance system. It's not quick enough to be competitive. So we prefer to work as an offshore company."[70] However, criticism of Petropars's structure, role, and leadership quickly mounted, motivated in equal parts by hard-liner suspicions toward reformists and resentment of an industry newcomer with a foreign registration and preferential access.

[69] Mahnaz Zahirinejad, "The Role of Political Structure in Iran's Energy Decision Making Policy," *Journal of Third World Studies* 29:1 (Spring 2012), p. 237.

[70] Then-Petropars Chief Akbar Torkan in Hugh Pope, "Internal Rules Limit Businesses in Iran," *Wall Street Journal*, June 29, 2002, p. B11.

Investigations by the parliament and the State Inspectorate Organization prompted the 2002 reconstitution of Petropars as an Iranian firm. It was then quietly transferred to Naftiran Intertrade Company, the Swiss-registered overseas arm of NIOC. Throughout its history, Petropars has been implicated in a series of scandals and allegations of corruption, but aside from the eviction of several high-profile reformists from its management, the scrutiny has generated little meaningful restructuring, other than further delays to South Pars development. Sanctions have thrust Petropars into an even more central role in South Pars's future development, and its role has evolved from facilitator of foreign investment to a favored vehicle for Iranian involvement in overseas upstream projects, including in Venezuela and Angola.[71]

In addition to Petropars, an array of well-connected spin-off firms has emerged with significant stakes in key upstream projects:

- Pedec was established in 1994 to serve as the main domestic partner for buyback projects. In 1997, Mehdi Hashemi, son of then-President Ali Akbar Hashemi Rafsanjani, managed to assume control of Pedec in what was perceived as a battle for turf, influence, and rewards. He was later replaced by Mehdi Husayni, a deputy oil minister and later the head of Kala in London.[72] During the Khatami period, Husayni was known as "Mr. Buyback," for his role in devising the contract model and negotiating many of the early deals. By 2000, Husayni was moved to Kala Naft in London, and Mehdi Mirmoezzi, deputy minister for exploration and production, took over Pedec. The firm's mandate was limited to three fields: Salman, Sirri C&D, and Farzam.[73] In 2000, responsibility for the buybacks was shifted to Pedec, led at the time by Ali Akbar Al-e Agha.
- IOEC was created in 1994 as a general contractor for the petroleum sector. Mehdi Hashemi headed IOEC in the 1990s, but the firm failed to win major deals, instead evolving into an engineering subcontractor and holding firm for other small technical firms. IOEC did manage to take a claim as a partner to Pedec. The company remains active in the

[71] Petropars has performed reservoir studies for several Venezuelan prospects and assumed a 26 percent stake in developing the Dobokubi oil field in Venezuela, in conjunction with the Venezuelan state oil company PDVSA. F. Milad, "Tehran, Caracas to Sign $2 Billion Oil Deal," *McClatchy-Tribune Business News*, May 29, 2012.

[72] "Iran – Who's Who," *Energy Compass*, October 6, 2000.

[73] "Iran – Homeward Bound," *Energy Compass*, July 21, 2000.

energy sector, constructing platforms and other facilities for several phases of South Pars.

- Petro-Iran Development Company, or Pedco, was also established in 1998 and incorporated in Jersey. Headed by Mostafa Khoee, the former chief of NIOC's offshore subsidiary (Iran Offshore Oil Company), Pedco emerged as a major player quickly when it won buyback contracts for the Salman field (with IOEC).[74]
- OIEC is another of the older subsidiaries, with a history that traces back to 1993. OIEC is a jointly owned subsidiary of NIOC (40 percent), NIOC Pension Funds (20 percent), and NIOC management (40 percent). OIEC took on minority stakes in Shah Denis (10 percent) and Lenkoran Denis (10 percent), another Caspian project under the auspices of TotalFinaElf.[75] In 2000, OIEC partnered with British Gas on a bid for South Pars Phases 9 and 10 and 11 and 12. During the Khatami period, OIEC was initially chaired by Ali Hashemi, who later chaired the parliament's Energy Commission. In 1999, the former construction minister Gholamreza Forouzesh took the helm and later acquired a 10 percent interest in the Soroush/Nowruz field development.[76]
- Naftiran Intertrade Co. (Nico) has emerged as one of the most important instruments of NIOC's arsenal, and an essential dimension of Iran's international commercial activities. It was created in 1992 in order to undertake barter deals in East Africa. In 1999, Iran's former ambassador to Italy, Majid Hedayatzadeh, took over Nico and brought to bear his prior diplomatic experience as well as his background as international relations chief for NIOC. Nico technically falls under the auspices of NIOC International but tends to overshadow its ostensible oversight body. Over time, Nico became an integral link in Iran's burgeoning financial relationships with the international banking system – the $3 billion credit facility negotiated during the Khatami era, for example, utilized Nico as the conduit.[77]
- A similar phenomenon has occurred in the petrochemicals sector, where privatization during the Ahmadinejad presidency has facilitated the establishment of numerous nonstate actors in this sector. In the process, "the petrochemical industry was cut into pieces and awarded to a group of individuals who only sought higher profits in

[74] Paul Sampson, "Who's Who in Iran," *Energy Compass*, May 25, 2001.
[75] "Iran – Who's Who," *Energy Compass*, October 6, 2000.
[76] Paul Sampson, "Who's Who in Iran," *Energy Compass*, May 25, 2001. [77] Ibid.

the short-term," according to the head of the state petrochemical company in April 2014.[78]

THE ZANGANEH ERA

After Khatami's 1997 election, Bijan Namdar Zanganeh was named oil minister. Zanganeh was more technocrat than reformist – he had helped found the Reconstruction Crusade and led that organization during the war. During his two-term tenure as Rafsanjani's energy minister, he was widely credited for rehabilitating the sector. The experience also gave him a keen appreciation of the importance of Iran's gas sector for its domestic economy, as well as the distortions caused by price subsidies for domestic energy use. In taking over the Oil Ministry – by definition, a vital post – Zanganeh pursued an ambitious agenda of increasing production, securing foreign investment, and reforming the sector itself. He argued that "Iran's oil industry has two choices; either it wants to be an updated mainstream industry and be present globally or else this is absolutely not important for it," adding, "we opted for the first choice."[79]

Zanganeh unleashed a barrage of new tenders for upstream activity, although the pace of decisions proved more difficult to accelerate. Foreign firms vying for a share of the spoils during the reform period included Agip/ENI, BHP, British Petroleum, British Gas, Elf/Total/TotalFinaElf, Enterprise, Gaz de France, Gazprom Lasmo, Maersk, Royal Dutch/Shell, and Petronas. At least $15 billion in upstream deals were signed during Khatami's first term, and in several cases the arrangements included enhancements to the existing buyback terms that offered the foreign firm a larger role in production decisions and other key aspects of the deal. In 2005, in the last round of international tender activity on South Pars, Phases 15 and 16 drew bids from four separate partnerships of foreign and domestic firms, including Hyundai/Foster Wheeler/Isoico, Technip/OIEC/Saff, Petropars/Daelim/Chiyoda, and Sabra/AK Kvaerner/Khatam al Anbia. During this period, even U.S. firms sought to position themselves for a future role in South Pars, buying technical data packages and leading Iranian officials to predict they might receive U.S. bids for Phases 9–12 in 2000.[80]

78 "Wrong Privatization Paralyzed Petchem Sector: NPC Chief," *IRNA*, April 19, 2014.

79 "Candid Chat with the Oil Minister about the Nation's Oil Performance and Strategy," *Noruz*, July 21, 2001, p. 15.

80 "US Companies Seen Submitting Bids for Iran Gas Field – Official," *Dow Jones Energy Service*, November 5, 2000.

Demonstrating a savvy appreciation of the political opportunities as well as the shifts within the sector, Tehran also reached out beyond the traditional IOC heavyweights to the national oil companies that were beginning to emerge as major industry players. Petronas and Gazprom joined TotalFinaElf in a successful bid for Phases 2 and 3 of South Pars in 1997. In 1998, BG submitted a joint bid for construction of the Neka-Tehran pipeline but found themselves outbid by a joint effort by Mapna and a Chinese-led consortium.[81] In August 1998, Bonyad-e Mostazafan partnered with CNPC for gas exploration in southern Iran.[82] The courting extended beyond well beyond Asia, however, particularly as sanctions and political risk began to erode the competitive position of Western companies. Brazil's Petrobras won a license to explore in the Gulf in 2003 and a year later was granted drilling rights in the Caspian. In 2000, after signing a series of European firms to major gas and oil deals, Iran's oil minister described U.S. sanctions as "a joke," adding that "the only thing it has succeed [ed] in doing is preventing American companies from investing in Iran."[83]

However, the track record of projects spearheaded by domestic Iranian firms has been marked by financial and logistical headaches. In 1998, Tehran was forced to shift from a domestic-led effort to boost production at the Nowruz field to an international tender when OIEC was unable to secure financing.[84] IOEC's buyback contract for developing the Soroush experienced similar issues, which cleared the way for Shell and Enterprise Oil to claim the contract. One of the difficulties was the parliament, which rejected efforts to insert flexibility in the fulfillment of buyback deals.'[85]

In October 1999, Tehran announced the biggest oil find since the revolution, the Azadegan field in southwestern Iran near the Iraqi border. At the time, Azadegan was believed to hold somewhere between 26 and 70 billion barrels of oil, with a potential production profile of 300,000–400,000 barrels per day for decades. The discovery seemed ideally timed for Tehran, since the advent of a reformist presidency had restored confidence among prospective investors in Iran's energy sector and political stability. Initially, a consortium of Japanese firms won the

[81] "Iran – Who's Who," *Energy Compass*, October 6, 2000. [82] Ibid.

[83] "Iran Makes More Headway on Gas Developments," *Energy Compass*, August 4, 2000.

[84] "Local Iranian Firms Struggle to Fulfill Own Contracts," *Petroleum Intelligence Weekly*, June 15, 1998.

[85] Ibid.

right to develop Azadegan, in a transaction that offered Tehran a $3 billion loan.

The lure of investing in Iran was not limited to European and Asian firms. Throughout the 1990s, American oil companies actively sought to position themselves for the future in Iran, lobbying against American sanctions, buying technical data on tendered projects, sending representatives to industry events in Iran, and mapping out prospective cooperation with foreign firms that did not face legal constraints and had already entered the Iranian market.[86] For his part, Zanganeh openly agitated for American firms' return to the Iranian oil sector. "I don't think [sanctions are] good for open and free trade. It's a decision that goes against both sides. It deprives U.S. companies from participating in our projects. We have money to develop our fields, but we would prefer to have the participation of first-class foreign companies."[87] This public advocacy of resumed U.S. investment contributed to Zanganeh's unpopularity among Iran's hard-liners.

Having experienced the most direct loss as a result of the intensification of American sanctions on Iran, Conoco lobbied publicly and strenuously against the restrictions and actively sought to maintain its position in Iran despite the sanctions. When Iran's parliamentary speaker, Mehdi Karrubi, and other MPs visited New York for the September 2000 UNGA, they attended a reception with U.S. oil executives – as well as members of Congress. Conoco even acknowledged in 2001 that its UK subsidiary had analyzed the data package for the Azadegan field.[88] For most other U.S. companies, however, Iran represented a potential danger zone rather than an imminent opportunity, and American firms typically opted to follow Iranian developments from afar and sought to avoid reputational or legal jeopardy in dealing directly with Iran.

Despite his apparent success and his centrist political stance, Zanganeh's tenure at the Oil Ministry was profoundly controversial. He emerged as a lightning rod for criticism and corruption allegations, primarily emanating from traditionalists who opposed the opening. In 2001, Ayatollah Ahmad Jannati, head of the Council of Guardians, inveighed against what he described as an Oil Ministry conspiracy to

[86] "US Companies Seen Submitting Bids for Iran Gas Field – Official," *Dow Jones Energy Service*, November 5, 2000.

[87] Neela Bannerjee, "Five Questions for Bijan Namdar Zanganeh; Toward Oil Price Stability, Step by Step," *New York Times*, June 25, 2000.

[88] Paul Sampson, "Politics in Limbo," *Energy Compass*, March 30, 2001.

embezzle funds, promising to name names. The parliament began agitating for more transparency, especially on terms of agreements concluded with IOCs. Because of its inherent limitations, the buyback model attracted criticisms even from supporters of foreign investment in the oil sector. NIOC Vice President Ghanimifard damned the contract model with faint praise as "the least damaging" mechanism for attracting foreign investment in the sector.[89] Technocrats within the sector and even the critics in the parliament appreciated that the risk-reward tradeoff was not sufficiently attractive to IOCs and argued that Iran bore the consequences of projects that were not optimally developed as a result of the lack of a long-term time horizon on the part of the foreign investors.

However, the debate on opening the sector to IOCs became caught up in partisan efforts to subvert Khatami as well as an ideologically motivated reluctance to embrace foreign development of Iran's petroleum resources. Much of the postrevolutionary élite remained convinced that foreign oil companies served as stalking horses of external influence and advocated using Iran's newfound surplus oil revenues for enhanced investment. Still others argued for deliberate restrictions on Iranian output to reduce dependence on petrodollars and/or preclude any weakening of worldwide prices as a result of expanded supply. And there was an overwhelming push for maintaining a dominant role for Iranian firms. Mostafa Taheri Najafabadi, chairman of the reformist parliament's Energy Committee, grumbled that the buybacks were "costly and not in our country's interests," adding that local firms "can do the projects on our own and step by step, making direct use of foreign loans and expertise."[90]

Senior officials doggedly refuted these arguments, engaging in an informal public education campaign that was not dissimilar to efforts undertaken to shift the official stance on birth rates and, later, on subsidy distribution. Iranian technocrats attempted to correct widespread misperceptions, particularly the notion that any dealings with the IOCs were inherently zero-sum in terms of their benefits. However, the official vindication campaign for buybacks was undertaken belatedly and was hampered by the industry's discomfort with transparency of its contractual arrangements. Ultimately, the barrage of domestic reproaches was sufficient to prompt the Expediency Council to intercede in February

[89] "Buy-Back Deals in the Dock," *MEED*, August 4, 2000. [90] Ibid.

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announced that twenty-one of the various subsidiary companies to its four primary operating consortia would be privatized but made little real progress in implementation.[103] There was also talk of shifting the country's vital enterprises outside Tehran and dozens of Ministry of Petroleum subsidiaries were included on the list of more than 160 government firms directed to move their operations away from the capital.[104]

Meanwhile, the aftereffects of sanctions shattered the long-standing NIOC monopoly of participation in oil and gas development. Historically, the state-owned oil company jealously guarded its turf and precluded all but a few favored state enterprises, such as IDRO, from gaining inroads into the sector. But Ahmadinejad's mercurial managerial style in relation to the withdrawal of foreign investors shifted that paradigm. These plans involved both the entry of new players into both the upstream development of fields and downstream marketing of crude sales, as well as the shift to seeking domestic financing through the sale of "participation bonds" in specific phases/projects of South Pars. Companies affiliated with the Revolutionary Guard, including but not limited to the Khatam al Anbia construction firm, reportedly secured as much as $25 billion in projects in the oil and gas sector in recent years, as did other domestic semigovernmental firms, including those associated with several large parastatal foundations that had previously been excluded from such activities.

The opening of the Iranian energy sector to private development also extended to the downstream. In 2008, Tehran launched an "oil stock exchange" on Kish Island as a means of facilitating direct sales in crude, petrochemicals, and refined products, including fuel oil and gasoline. In 2009, the oil ministry granted authority to the Bonyad-e Mostazafan, then headed by a former military officer who had once been intended to take over NIOC itself as managing director, for oil sales. In April 2012, Hassan Khosrowjerdi, who then headed the Association of Oil, Gas and Petrochemicals Products Exporters, suggested that private companies had been responsible for $18 billion worth of exports in refined petroleum products over the previous year, and he as well as other industrial officials indicated that the government may also facilitate upstream

[103] "Iran Oil Ministry Names Twenty-One Firms Set to Be Privatized," *Mehr News Agency*, July 14, 2007; F. Milad, "Iran Plans to Privatize 95% of Oil Ministry's Subsidiaries," *McClatchy–Tribune Business News*, January 25, 2012.

[104] "One Hundred and Sixty Three Government Firms to Leave Tehran," *Hemayat*, May 20, 2010.

involvement.[105] Notably, most of these companies appeared to be linked to holding firms associated with the Revolutionary Guard Corps, calling into question whether they were actually independent of government ownership or control. At least three private sector consortia were established with the specific intention of trying to "bypass" sanctions.[106]

In addition to reconfiguring the sector to cope with sanctions, among the other hallmarks of the Qasemi management of the oil sector were revived concerns about the exploitation of shared fields and the prospects for conflict with Iran's neighbors over the faster pace of development in Iraq and the Gulf. There were mounting critiques of Qatar's rapid exploitation of its North Field, which is part of the same geological structure as Iran's South Pars, as well as Kuwaiti and Saudi efforts to develop the Arash (Dorra) gas field in the Gulf. Tehran sought to assert what the leadership considered to be its sovereign rights to fields adjacent to disputed boundaries in the Caspian Sea and along the border with Iraq, and it is hardly inconceivable that as tensions mount over sanctions and Iranian regional influence, direct conflict could erupt in one of these areas as Tehran seeks to flex its muscles and intimidate its neighbors. In July 2012, Mahmoud Zirakchianzadeh, managing director of the Iranian Offshore Oil Company, announced that Tehran was seeking to develop Arash (Dorra) jointly with Kuwait, but added that "if Iran's positive diplomacy is turned down, we will be carrying on our efforts at Arash field unilaterally."[107] Add to these suspicions the simple reality that through their expanded production and other measures to blunt Iran's oil might, the Gulf states played a significant role in enabling the sanctions on Iran to succeed. Such a context tempts some within Iran's security establishment to periodically issue vague warnings of possible reprisals against the ability of neighboring states to export their own oil and gas.

China Rising

Although Iranian leaders initially directed their efforts to luring foreign investment from traditional European trade partners, the energy relationship with China quickly took on increasing significance. Iranian leaders

[105] http://shana.ir/184656-en.html; http://shana.ir/188364-en.html

[106] Narges Rasuli, "Three Consortia Have Been Formed to Bypass Sanctions," *Etemad*, July 12, 2012.

[107] "Gas Field Development – Iran to Cooperate with Kuwait," *Pakistan and Gulf Economist*, July 29, 2012.

explicitly sought to utilize China as a bulwark against Western pressure, deliberating privileging Chinese companies with major deals in the expectation that this would both reinforce Chinese disdain for sanctions as well as splinter the increasing coherence of the international effort to isolate Tehran. Beijing appeared willing to expand its economic ties with Iran irrespective of – or perhaps as a subtle but tangible rebuff to – increasing Western agitation over Iranian foreign policy.

In 2004, in the midst of a major American push to escalate pressure on Iran, Sino-Iranian economic ties began to expand dramatically through a series of blockbuster energy deals. These included a $20 billion agreement inked in March 2004 with a Chinese state oil company, Zhuhai Zhenrong, for 2.5 million metric tons of LNG per year for twenty-five years, billed in typically inflated terms as the world's largest natural gas purchase to that date.[108] Later that year, Sinopec signed a $100 billion deal for a 51 percent stake in the Yadavaran field. Iranian politicians trumpeted these investments as evidence that sanctions cost the West more dearly than they did Iran.[109] Washington openly criticized the deals, suggesting that they would "undermine" international efforts on the nuclear file; however, Chinese officials shrugged off the rebuke, arguing that commercial arrangements should have no bearing on security issues, and vice versa.[110] China eventually supported international pressure on Iran over the nuclear issue, but the energy deals signaled its growing stake in the region's upstream assets.

After three years of delays, the first Yadavaran development contract was signed with Sinopec in December 2007, with the National Iranian Oil Company awarding a $2 billion deal to the Chinese firm for the first stage of the field's development. Shortly after the deal was signed, it was reported that Sinopec was increasing its imports of Iranian crude from 60,000 b/d in 2007 to 160,000 b/d in 2008, singlehandedly increasing China's Iranian oil imports by one-third. A NIOC source reported that this increase was tied to the Yadavaran deal.[111] Analysts suggested that more attractive terms to the buyback contract used in the Yadavaran deal reflected Tehran's desire to induce Chinese participation and blunt

[108] John W. Garver, *China and Iran: Ancient Partners in a Post-Imperial World* (Seattle: University of Washington Press, 2006), p. 271.

[109] "Baztab-e Gostardeh-ye Emza-ye Qarardad-e Nafti-ye Iran va Chin [Widespread Reaction to the Signing of the Iran-China Oil Contract]." 19 Azar 1386, December 10, 2006. http://www.shana.ir/121108-fa.html

[110] "China Stands by Iran Deal," *Oil Daily*, December 13, 2007.

[111] "China to Buy More Iranian Crude," *Oil Daily*, December 17, 2007.

Beijing's cooperation with American efforts to strengthen international sanctions on Iran.[112]

The United States openly criticized the Yadavaran deal. However, China vociferously defended the contract as "commercial cooperation in the energy sphere undertaken by a Chinese company with Iran following the principle of equality and mutual benefit."[113] Just one day before the UN Security Council passed Resolution 1696 in 2006, threatening Iran with sanctions if it did not suspend enrichment within a month, Sinopec signed a $2.7 billion deal to upgrade and expand the Arak refinery.[114]

However, from that high point, Chinese investments in Iran's energy sector began to stumble as Beijing assumed a more direct role in the nuclear negotiations with Tehran. Following a December 2006 memorandum of understanding, a deal between China National Offshore Oil Corporation (CNOOC) and Iran for the development of the North Pars gas field was significantly delayed – reportedly because of U.S. opposition.[115] It was not until March 2009 that Oil Minister Gholam-Husayn Nozari announced that CNOOC had signed the deal to develop the field for LNG export. The upstream phase of the project was projected to cost $5 billion and the downstream phase $11 billion; it was projected to be completed by 2012, when CNOOC was expected to purchase half of the output, or 10 million mt/yr, for twenty-five years.[116] However, sanctions kept any actual investment on ice, and after Iran's 2013 presidential election returned many technocrats to the oil sector, Tehran reportedly nullified the Chinese contract.

Beijing did seek to take some advantage of departures of other prospective foreign investors. In January 2009, China National Petroleum Corp. (CNPC) signed a $2 billion deal to develop the North Azadegan onshore oil field, to be carried out under a "revised version" of Iran's frequently used buyback scheme.[117] Even as Total renewed its hesitancy to follow through with its plans to develop South Pars, in March a senior

[112] Paula Dittrick, "Yadavaran Buyback Contract Signals Better Iranian Terms," *Oil & Gas Journal*, January 14, 2008.

[113] "China Stands by Iran Deal," *Oil Daily*, December 13, 2007.

[114] Clara Tan, "China's Sinopec Signs Iran Refinery Deal, Despite Crisis," *International Oil Daily*, August 2, 2006.

[115] "China's CNOOC, Iran LNG Deal Delayed on US Concerns, Talks Still On – Source," *Xinhua Financial News*, April 8, 2008.

[116] "China's CNOOC, Iran Sign North Pars Deal," *Platts Oilgram News*, March 17, 2009.

[117] Paul Sampson, "CNPC Deal with Iran Poses Foreign Policy Test for Obama Administration," *Oil Daily*, January 15, 2009.

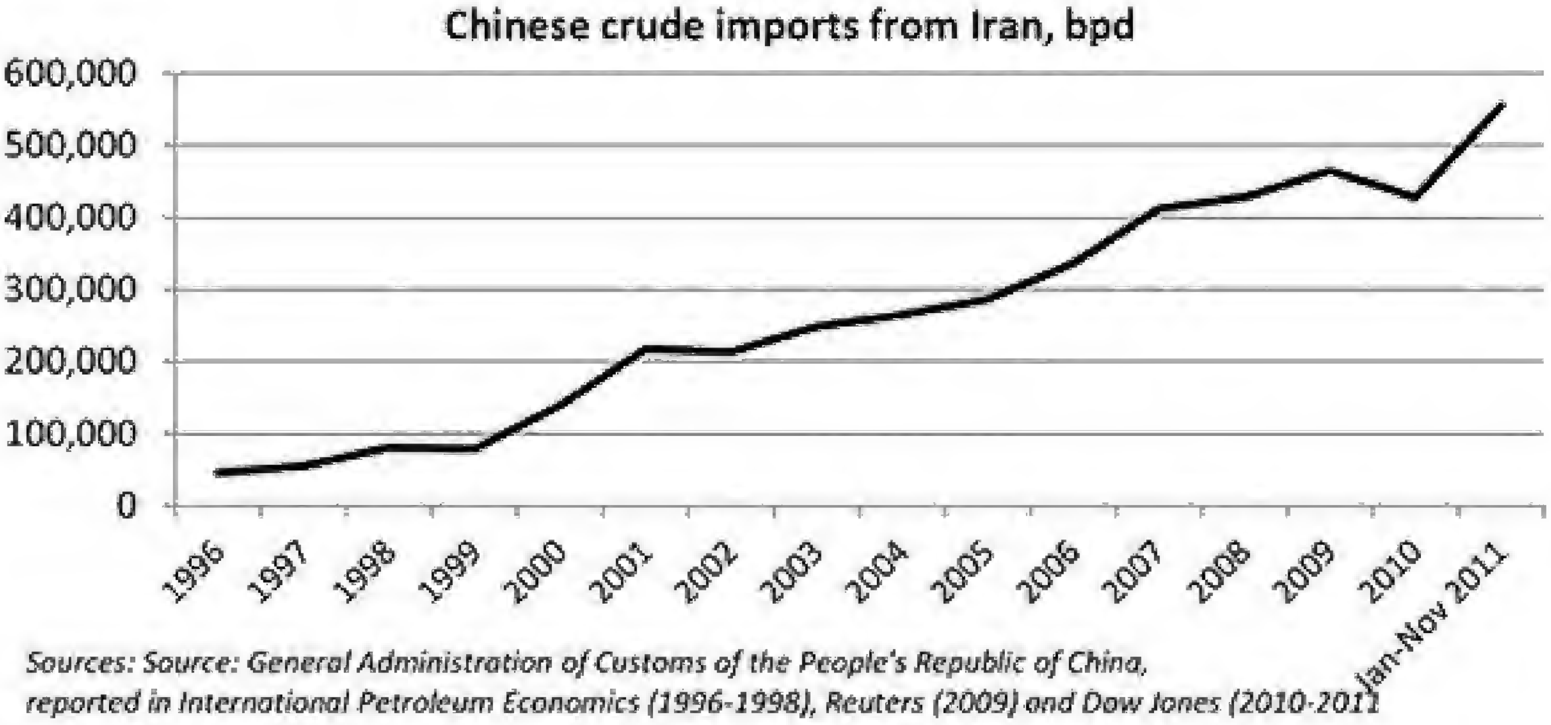

FIGURE 8.3. China's Crude Oil Imports from Iran

government official in Iran reported that an unnamed Chinese consortium had signed a $3.2 billion three-year deal for the field, with cooperation planned with an unnamed European nation. This occurred just two days after a renewal of U.S. sanctions by the Obama administration.[118]

Since 2010, the disparity between the universally applicable sanctions imposed under various United Nations resolutions, which carefully avoided any specific measures directed at the petroleum sector, and those more narrow measures adopted by Washington and its allies created a gaping need for Tehran and a fortuitous opportunity for Beijing to expand their cooperation on energy. The combined impact of long-standing U.S. sanctions and more recent measures adopted by the EU, Norway, Japan, South Korea, and several other states prohibited virtually all major Western oil companies from new investments in the Iranian energy sector and eventually from selling refined petroleum products to Tehran as well.

In such a context, China was left as the most significant international actor in Iran's energy sector. As Figure 8.3 demonstrates, Beijing represented an increasingly important destination for Iranian crude exports. Chinese companies, faced no direct legal constraints – they were the only major players left standing in the Iranian energy sector after the 2010 intensification of pressure on Tehran. Sinopec moved forward on its development of Yadavaran field, and other Chinese companies sought stakes in developing major oil and gas fields, including Azadegan (North

[118] Borzou Daragahi, "Iran, China Sign Gas Deal; The $3.2-Billion Pact to Develop An Offshore Field Stymies Sanctions," *Los Angeles Times*, March 15, 2009.

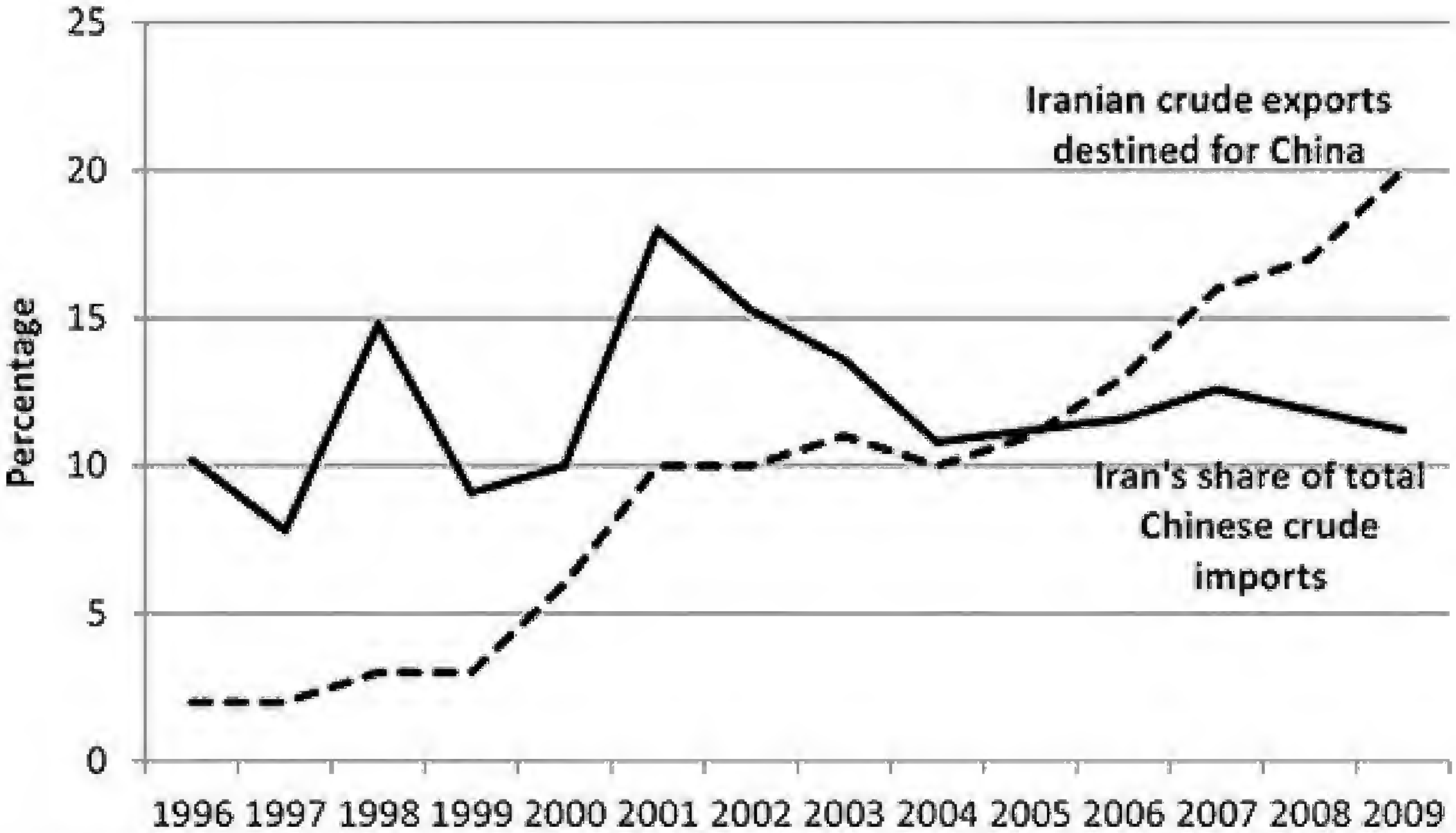

FIGURE 8.4. China Represents a Growing Proportion of Iran's Crude Exports

and South), South Pars (Phase 11), and North Pars. In addition to its upstream stakes, the financial and political premiums ensured that Beijing was content discreetly to flout the threat of U.S. sanctions against its companies that continued to sell gasoline and other fuels to Tehran.

Chinese companies also engaged in preliminary discussions with Tehran surrounding plans to boost refinery capacity and performance. In this fashion, China became the indispensable foreign partner for Iran's energy sector. In 2011, China imported an average of 540,000 bpd from Iran, nearly 20 percent of Iran's total exports – making Beijing Tehran's most consequential customer in terms of both volume as well as strategic value. At 8.4 percent of China's total crude import basket in 2011, Iran's share was still significantly lower than Chinese imports of Saudi crude and oil products (14.5 percent.) In other words, as Figure 8.4 underscores, China became more important to Iran's bottom line, even as Iran became comparatively less significant within Beijing's supply alternatives.

Chinese companies moved carefully not to absorb major new upstream projects after 2010, when in the wake of the new sanctions, U.S. officials warned that any Chinese "backfilling," or replacement of departing European firms, in energy projects would provoke tensions with Washington. Sinopec and CNPC clearly slow-rolled their investments in Iran with a careful eye on the \$20 million ceiling for the applicability of U.S. sanctions under the 2010 Comprehensive Iran Sanctions and Divestment Act (CISADA, which succeeded and expanded upon the Iran-Libya

Sanctions Act and its heirs). The slow pace of China's activities earned the ire of senior Iranian officials, including public recriminations from Oil Minister Rostam Qasemi and blunt discussion of replacing the Chinese firms. Still, Tehran's alternative options were drastically limited by the U.S., European, and other investment bans, and domestic critics of the leadership scoffed at the regime's attempt to browbeat Beijing into a more forthcoming posture.[119] In recent years, China's monthly imports from Iran varied considerably, from a high of more than 730,000 bpd in May 2009 to a low of less than 189,000 bpd a year later. These fluctuations continued after the imposition of the Central Bank sanctions, albeit at lower overall volumes, reflecting seasonal shifts in demand and pricing disputes.

Iran's Great Gas Game

Iran's gas industry remains heavily focused on development of the massive South Pars field, appropriately so since the field contained 47 percent of the country's total recoverable gas reserves. The first ten phases of an anticipated twenty-four-plus-stage development plan are already online, and while this is zealously celebrated by regime officials, Iran's technocrats quietly grumble about the extent to which development has lagged and the costs this has imposed on Iran.[120] Production from South Pars accounts for approximately one-third of Iran's gas production, and the investments in the field helped fuel exponential increases in Iran's gas consumption over the course of the past two decades. Production from South Pars Phase 1 totals 28.2 bcf per day (800 mcm/d) and rose to more than 35 bcf per day (1 bcm/d) by the end of the Iranian year in March 2013.[121]

During the Khatami presidency, these expansions prompted concerns within the international energy sector that Tehran would "end[s] up with more gas than it can handle."[122] However, development of South Pars, the crown jewel of Iran's gas reserves, moved considerably more slowly

[119] *Donya-ye Eqtesad* (online), "The Oil Minister: 'Chinese! Do Not Delay,'" September 19, 2011.

[120] Zoreh Kamizi, "Iran Lacks Energy Diplomacy," *Etemad* (supplement), February 1, 2010.

[121] "Gas Production Capacity of South Pars Phase 1 to hit 1b sqm," *IRNA*, July 23, 2012, http://irna.ir/News/Economic/Gas-production-capacity-of-South-Pars-phase-1-to-hit-1b-sqm/80243151

[122] Vahe Petrossian, "Iranian Gas at the Crossroads," *Upstream*, July 13, 2001.

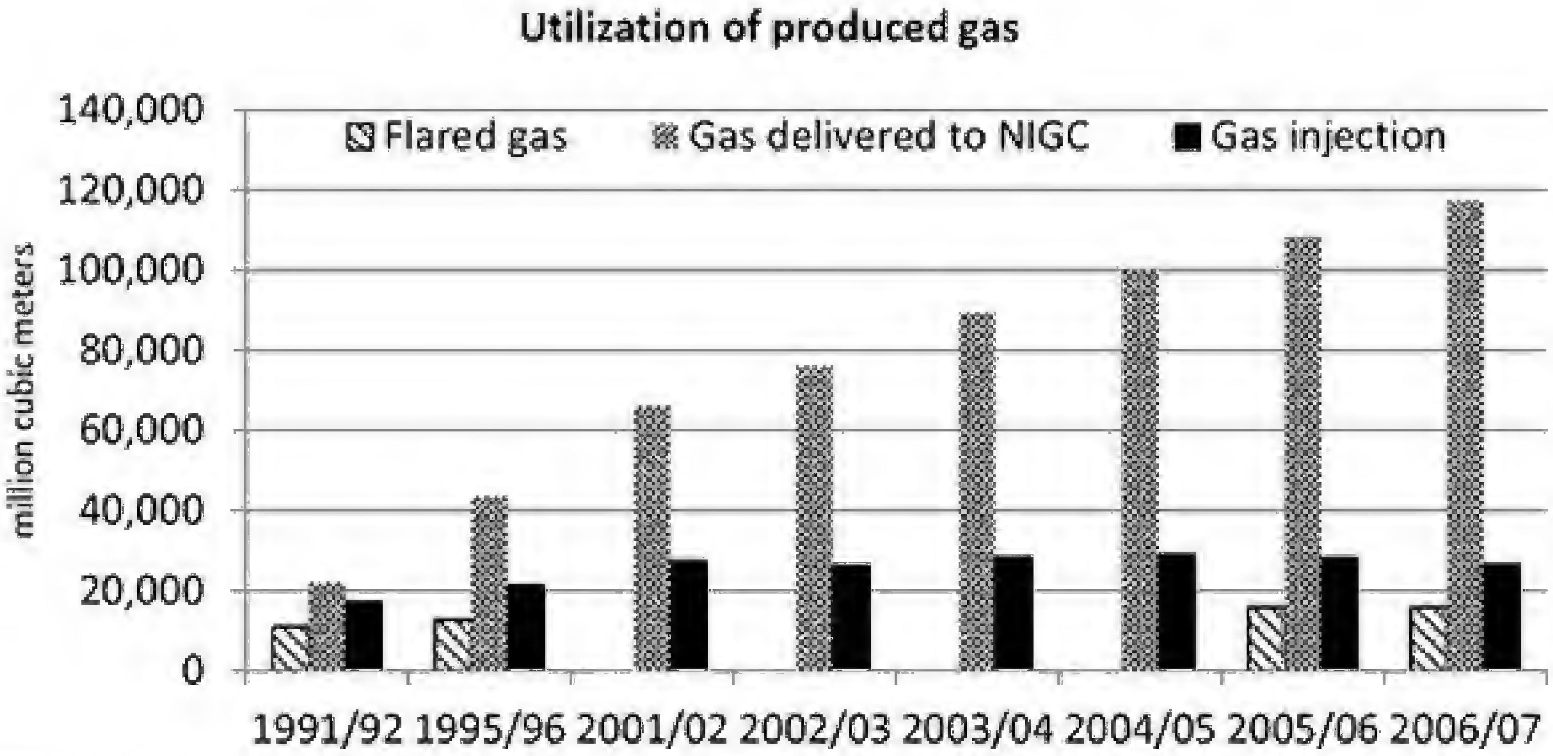

FIGURE 8.6. Iran's Increasing Gas Production and Usage

3 bcf destined to boost production at the Aghajari field from 140,000 bpd to 200,000 bpd, utilizing gas produced in Phases 6, 7, and 8 of South Pars.

Beyond domestic demand, power generation, and reinjection, Tehran sought to capitalize on its gas to buttress a petrochemicals industry that until recently had been growing at rapid pace. Sanctions and related difficulties in obtaining sufficient capital contributed to delays in completing two major new gas processing plants, Bid Boland-2 and Parsian.[126]

Iran's gas trade with Turkey was interrupted on a regular basis by political, security, and market issues, including Turkish terrorism and problems from both the demand and supply sides of the equation. Turkish demand repeatedly came up short, and under the terms of agreement Turkey was obligated to pay $600 million in 2009. Iran's gas exports to Turkey rebounded in 2010 by nearly 50 percent, but Ankara continued to press Tehran for price reductions. In 2011, Tehran demanded compensation for yet another interruption but was rebuffed by Ankara. The greater disappointment was that the Turkish deal never fulfilled the larger ambitions of Iranian policy makers – that is, to serve as a gateway to European exports and situate Iran as the hub of a robust supply network.

As part of its fifth Five Year Plan, launched in March 2010, Tehran set out an agenda of massive investments in the gas sector that included the construction of the ninth in the IGAT pipelines. Iran continued to pursue

[126] "Iran Gas Plants Face Delays," *MEES*, January 31, 2011.

piped gas export projects that showed little sign of immediate viability from either a political or a commercial perspective, including a pipeline to Pakistan (and in some guises, India) as well as a joint project with Iraq, Syria, and Lebanon that would extend to serve European demand as well. In each of these cases, Tehran sought to create facts on the ground by developing domestic pipeline capacity to service anticipated export routes and signed a variety of preliminary agreements with Islamabad and Damascus in order to facilitate discussions on pricing and infrastructure. Khatam al-Anbia was tapped to build a portion of the next IGAT, intended to serve future gas exports to Europe.[127]

It is not coincidental that Tehran sought to depict each of these projects in ideological terms – the official Iranian media and industry sources dubbed the South Asian pipeline as the "peace pipeline" and the Syrian route the "Islamic pipeline." Beneath the posturing lay a sense of Iran's evolving strategy for navigating the constraints of its ongoing frictions with the world – identifying prospective trade and investment partners with shared antipathies and limited options. This was hardly a recipe for prosperity or sensible development of the gas sector – neither the South Asian pipeline nor the Arab route had a viable business model in the near or medium term.

The "peace pipeline" to South Asia was in the works since at least 1994 but was repeatedly stalled by political frictions, security concerns, and difficulties in agreeing upon a pricing formula. In May 2009, Tehran signed a Gas Sale and Purchase agreement with Pakistan and subsequently inked a gas transportation agreement with additional guarantees intended to facilitate the countries' respective construction of the pipeline in 2010. Tehran claims that it has completed the domestic portion of the pipeline, and in 2015 Pakistan was in talks with a CNPC subsidiary to complete its segment of the pipeline.

By virtue of necessity, Iran's approach to gas exports was characterized by opportunism. When talks with Pakistan on piped gas foundered, Tehran revived the dormant Iran LNG project that had been associated with South Pars Phase 12 as a prospect for gas exports to India. The Arab pipeline network also shifted form to adapt to changing geopolitical circumstances and/or opportunities. With sanctions impinging on its finances and energy partnerships, Tehran turned its attention to utilizing the gas domestically and serving as a regional electricity hub, including

[127] "IRGC Company Wins Two Pipeline Contracts," *MEES*, March 4, 2011.

major projects for electricity supply to Iraq, Afghanistan, Pakistan, and other neighboring states including Armenia, Azerbaijan, Turkey, Turkmenistan, and Russia.

Iran also pursued the possibility of gas exports and/or joint development projects with neighboring states, but these projects have not yet generated exports, and the regional political climate effectively deterred any possibility that they would come to fruition until sanctions were lifted. Even before the escalation of frictions between Iran and the Gulf States, a combination of political and pricing obstacles had scuttled prior efforts to establish meaningful gas trade within the region. Iran's protracted negotiations to supply 500 mcf per day of gas to the UAE produced only acrimony on both sides; a deal with Dana Gas, based in Sharjah, collapsed over pricing disputes. Tehran engaged in period negotiations with Kuwait, Oman, and Bahrain and signed preliminary agreements with Kuwait in 2003 and 2010. Often these talks appeared designed to serve as public relations gambits. After Rouhani's election, Tehran pursued gas export deals with Oman and Iraq with apparent new seriousness.

Iran sought to develop LNG production from the initial development of South Pars. Three major projects – Iran LNG, Persian LNG, and Pars LNG – were originally devised, with plans for initial exports to begin in 2011. Pars LNG and Persian LNG were intended to utilize South Pars production Phases 11 and 13 and 14, respectively, and had attracted strong interest from foreign investors including TotalFinaElf and Petronas in Pars LNG and Shell/Repsol in Persian LNG. However, both projects were formally suspended in 2010, in an implicit acknowledgment of the impact of sanctions as well as the shifting realities of the global gas trade.[128]

The pair of 5.4 mt/year trains envisioned as part of Iran LNG were reassigned from Phase 12 of South Pars to Phase 11, to enable the volumes produced from the already-underway Phase 12 to feed into the IGAT trunkline system and supplement volumes available for domestic consumption. The political environment and sanctions regime deterred investors and prospective purchasers alike – generating a self-perpetuating cycle of failure that Tehran could do little to mitigate, as early discussions and preliminary deals with companies such as Sinopec and OMV withered on the vine.

Without the technology and without firm contracts for purchase, there was little that Tehran could do to advance these projects. A number of the

[128] Benoit Faucon and Spencer Swarz, "Iran Curbs LNG-Export Ambitions," *Wall Street Journal*, August 12, 2010.

foreign firms involved with the projects had already withdrawn or signaled their disinterest in moving forward and wrote off tens of millions in costs associated with the aborted projects. Some facilities associated with the Iran LNG project, including storage tanks constructed by the Iranian firm Panahsaz Iran Engineering Company, were left effectively idle. "We do not dare buy given the political issues. What would happen if we sign a deal?" an Asian buyer queried a reporter in 2011, adding that beyond the sanctions, "Iran's sluggish progress on construction of the liquefaction plant and its lack of any prior track record in LNG makes prospective customers very skittish."[129]

Tehran continued to promote a vision of the country as a major supplier to its neighbors as well as to demand centers in Europe, with the intention of expanding Iran's share of the international gas market from 1 percent to 10 percent.[130] In 2013, Javad Owji, then head of Iran's gas company, predicted that gas exports would triple to 100 mcm by 2014, as pipeline sales to Iraq and Pakistan expanded upon the modest levels of Turkish exports. Owji forecast that gradually these projects would shift the basis of Iran's resource rents from oil to gas.[131] However, the vision of Iran as a major gas exporter appeared to be largely divorced from reality; beyond the sanctions , Iranian officials seemed to disregard the historic shifts in the gas market that had ensued with the emergence of unconventional supplies, including shale. Iranian officials reportedly were rebuffed in efforts to launch gas export talks with a range of European and Russian firms.[132] Meanwhile, Iran's only remaining European export prospect – a preliminary agreement signed in 2008 with a Swiss company for 20–25 mcm in gas exports – remained in limbo as routes and supply options were considered. Still, Tehran claimed to be banking on a future as a diversified exporter, with a projected 6.35 bcf/day (180 mcm/d) intended for Turkey, Europe, and South Asia.[133]

Beyond its modest pipeline exports and continually deferred dreams of LNG, Tehran managed to establish a growing revenue stream from South Pars condensates production. Exports of condensates brought in more

[129] "Iran LNG Advances, Buyers Still Balk," *World Gas Intelligence*, April 27, 2011.

[130] Ali Khajavi, "Strategies for Iran's Effective Interaction in the Global Gas Market," *MEES*, January 21, 2011.

[131] Ladane Nasseri, "Iran to Boost Gas Exports in Efforts to Cut Oil Sales Reliance," *Bloomberg News*, April 7, 2013.

[132] "EU Advisor: Aipg, Repsol, LukOil Reject Iran's Gas Proposal," *Iran Economy Review*, July 31, 2012.

[133] "Iran Plans to Export 180 mcm of Gas per Day," *Shana News Service*, June 9, 2012.

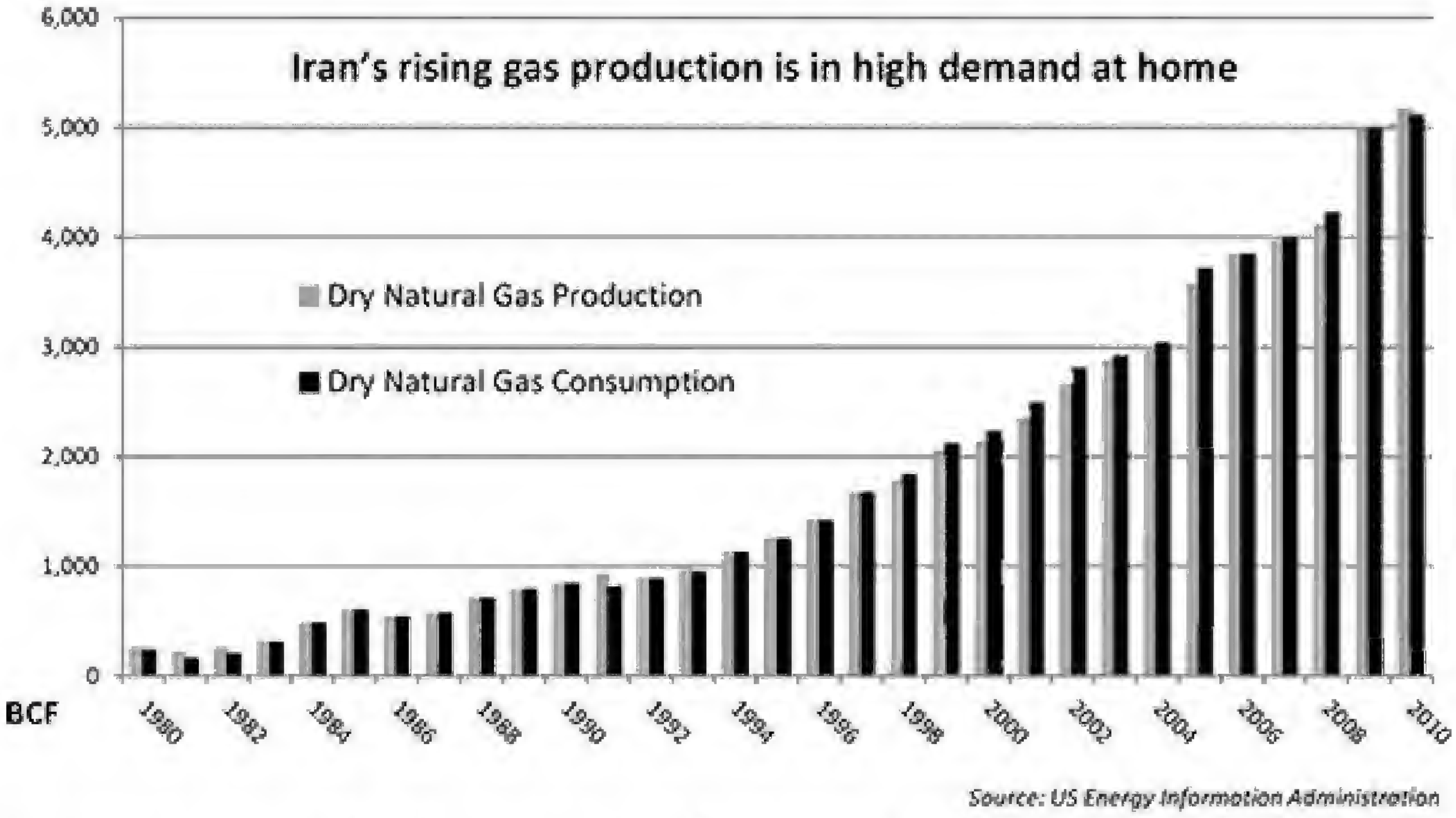

FIGURE 8.7. Nearly All of Iran's Gas Production Is Consumed Domestically

than $9 billion in the Iranian year that concluded in March 2012, and Tehran planned to build two additional gas refineries aimed at expanding production threefold.[134] There is an inherent tension between seeking to monetize condensates production via exports and utilizing the production to offset the need for imports of refined petroleum products. However, the U.S. sanctions on Iran's Central Bank, which imposed limitations on oil export volumes, inadvertently encouraged the expansion of condensates exports, which were not subject to the restrictions.

Because of the distance between supply and major centers of domestic demand, Tehran also established import relationships with several Central Asian neighbors and imported small but steady volumes from Turkmenistan via the Korpezhe-Kurt Kui pipeline from 1996 to enhance gas supplies available to northern Iran. A second pipeline was launched in December 2009 and expanded in November 2010 to facilitate as much as 45 mcm/day eventually, taking advantage of the Dowlatabad field. With another northern neighbor, Azerbaijan, Tehran established a swap arrangement that exchanged Iranian supply to the Azeri enclave of Nakhchevan in Armenia and in 2011 agreed to another deal for up to 5 bcm/year by 2015.

[134] Al Kroner, "Condensate Trade Will Reshape Oil, Gas Markets East of Suez," *Oil & Gas Journal*, February 6, 2012.

the rural areas.[139] Industrial usage also skyrocketed – from approximately 280 plants in 1980 to 1,100 by 1993. Demand was estimated to increase at approximately 3.8 percent per year through 2030.[140]

Iran has thirty-one gas-fed power plants, and during periods of peak usage – most notably, during winter freezes – residential demand escalates sharply, and on repeated occasions the government was forced to cut supply internally, constraining petrochemical plants, oilfield reinjection and other industrial usage, as well as to export customers such as Turkey in order to fulfill household demand. Iran's transmission capacity of 750 mcm per day has outpaced production capacity (650 mcm/day), but Tehran is preparing for additional phases of South Pars feeding into the system, seeking to add some 9,000 km of pipelines and sixty-five pressure boost stations by 2015.

Sanctions have helped foster domestic utilization, in limiting Iran's export options and in providing additional impetus for the 2010 implementation of subsidy reforms. The program targeted multiple aspects of the vast government support for basic commodities, whose direct tab had totaled $66 billion by 2009. Approximately 15 percent of that total related to gas, and to date the initiative has had conflicting impacts on gas consumption and future demand.[141] One of the primary goals was to reduce a major vulnerability for the Iranian economy – the reliance of a country with among the largest energy reserves in the world on imports of gasoline and diesel for as much as 40 percent of domestic usage.

In order to mitigate the consumer shock of raising gasoline prices and to dampen the persistently rising domestic demand for gasoline that had left the country dependent on product imports for much of its daily usage, Tehran undertook a major effort to shift the country's transportation fleet to compressed natural gas (CNG). This initiative included the adoption of smart cards for all vehicles and fuel pumps that ration lower-cost gasoline on the basis of consumption and subsidized conversion for individual vehicles to CNG. The outcome of this effort was a massive increase in CNG capacity. By mid-2012, Iran claimed to have established more than nineteen hundred of an anticipated twenty-five hundred CNG stations, with 2.8 million vehicles on the roads fueled by CNG.[142]

[139] Qasemi address to parliament, *Shana News Service*, June 25, 2012.
[140] Brumberg/Jaffee paper, p. 26.
[141] Ali Khajavi, "Strategies for Iran's Effective Interaction in the Global Gas Market," *MEES*, January 21, 2011.
[142] *Shana News Service*, June 20, 2012.

over contested territories. The issue of Iran's twenty-eight fields whose geological structures are shared with neighboring states has been raised with greater frequency in recent years. Then-Oil-Minister Rostam Qasemi has repeatedly raised the question of extraction rates from twenty-eight fields that straddle Iran's borders with its neighbors, including Iraq, Kuwait, Saudi Arabia, and, most sensitively, Qatar. In August 2012, Qasemi declared, "it is the right of the people of Iran to have not an equal share but a bigger share of these resources." Another senior Oil Ministry official declared that Iran had "a national duty for us to protect this capital."[155]

In July 2001, Tehran dispatched naval gunships to warn off an Azeri oil exploration vessel operating in Caspian Sea waters that Iran claims as its own in its ongoing dispute with the other five Caspian littoral states over the post-Soviet division of the waters. The incident ended peacefully, and successfully from Tehran's perspective, with the research vessel, leased to BP, retreating and representatives of both the company and the British government assuring Iranian officials that no further actions would be taken so long as the territorial claims remained unresolved.

The relative status of South Pars's exploitation is the subject of increasing anxiety for Tehran; the geological structure is shared with Qatar's North Field, and the disparity between development and depletion rates on the Qatari side has sparked concerns that the delays and obstacles experienced by Tehran will eventually forfeit the field's potential. One expert estimates that Doha has gained $55 billion and is set to earn another $100 billion in part because of the lack of serious competition from Iran.[156] This assessment of a production imbalance favoring the Qataris is not universally shared; in fact, some analysts contend that Tehran may bear some share of culpability in depleting the reservoir at a sharper decline rate than its relative share of the asset would imply.[157] At the same time, with financial pressures mounting along with frictions

[155] "The Widespread Extraction from Joint Oil by Arabs," *Donya-ye Eqtesad*, August 21, 2011.

[156] Kamizi, *Etemad* (supplement), February 1, 2010.

[157] Witfield (2011) argues that "the classic problem of drainage only exists if one party in a non-unitized field produces more than his share of the reserves. Since the North Field reserves are roughly twice those in South Pars, balanced production would have Qatar producing twice as much as Iran. It is important to note that Iran is currently producing more than its share would justify. If Iran is ultimately successful in developing its 22 South Pars blocks, its planned production would substantially drain reserves from Qatar's much more modest development plans." Alex Witfield, "Understanding Middle East Gas Exporting Behavior," *Energy Journal* 32:2 (2011), p. 215.

with Iran's neighbors, the Iranian tone on South Pars and other shared fields, including the Arash gas field, which is shared with Kuwait, tended to sharpen.

In addition, Iran is confronting a huge challenge in adapting to a changing international gas market. Tehran played an early, enthusiastic role in the establishment of an organization of gas exporting nations intended to evolve into a gas analogue to OPEC. To date there is little evidence that a suppliers' cartel can achieve even the minimal level of cohesion and efficacy that characterizes OPEC's experience, which itself benefited from a broad initial shared interest among the host governments in wresting greater control of price and production decisions from the concessionary companies. The Gas Exporting Countries Forum, or GECF, can claim no such collective sense of mission; its primary advocates, which include Russia and Qatar as well as Iran, developed their industries quite differently and are direct competitors for export markets. Even as the organization has sought to establish itself, changes in energy markets – specifically, the advent of hydraulic fracturing technology – have dramatically expanded supply, depressing gas prices and introducing new prospective heavyweight producers into the marketplace, including the United States, further dissipating GEFC's early prospects.

Although Iran has little rationale or capacity to move beyond its conventional resources, the Petroleum Ministry has sought to position the country for the new era of gas, announcing several studies including those to ascertain shale prospects as well as gas hydrates. However, the NIOC exploration director, Mahmoud Mohaddes, has already acknowledged that shale is "not economical" given Iran's conventional reserves.[158]

Finally, Iranian decision-makers will have to engage more serious in the debate over how to attract and maintain foreign investment in the energy industry. Many within the energy technocracy appreciate that the buyback contract is a problematic model for the country's development simply because its terms are not terribly beneficial to international companies and tend to discourage the sort of long-term sense of shared investment that is most conducive to optimizing Iran's resources. However, the opposition to foreign ownership runs deep within the existing system, and Iran's historical experience has inculcated a long-standing and widely shared sense that the country's national wealth was stolen for decades by its original foreign oil partner. Even as technocrats resumed

[158] "NIOC Conducting Study on Shale Oil," *Shana News Service*, July 15, 2012, http://shana.ir/192440-en.html

influential positions throughout the oil sector and state economy, deep mistrust of foreign companies and governments will remain intense as it relates to Iranian petroleum resources. For that reason, the legal rejection of foreign ownership of petroleum resources (and the corresponding implications for the ability of international companies to "book" reserves) is likely to remain intact irrespective of any future shifts in the ideological complexion of the Iranian regime.

9

Sanctions and the Sacred State

The 1979 revolution was never simply about Iran: Its ambitions were explicitly transnational, and its demons – the forces that animated the movement and the state that it generated – always transcended Iran's borders. The revolutionaries harbored profound bitterness toward Washington and other major powers, as well as toward the international system that empowered them and sustained the monarchy; such sentiments have only been exacerbated by three and a half decades of international pressure. At the same time, as this book details, the Islamic Republic has remained intricately engaged with the global economy through its reliance on energy production and exports.

Revolutionary Iran's engagement with the international economy has been molded by a variety of factors: its historical legacy; the politics of protectionism; heavy-handed exchange rate management, which has facilitated imports and depressed nonoil exports; and of course Iran's prickly relations with the West. The country's trade patterns shifted considerably over time thanks to the Islamic Republic's policies, as well as in response to regional and global changes – the demise of the Soviet Union; conflicts in Lebanon, Iraq, and Afghanistan; the rise of Asian economies.

However, the revolution added a new factor – international economic restrictions – that has persisted and loomed ever larger in dictating new patterns of engagement with the world, and eventually reconfiguring the Iranian economy. From the initial measures undertaken after the 1979 embassy seizure to the mushrooming labyrinth of restrictions imposed after Iran's 2006 referral to the United Nations Security Council, understanding the sanctions regime – and Iran's responses to it – is critical to appreciating the political economy of the Islamic Republic.

SANCTIONS AND THE HOSTAGE CRISIS

The November 1979 embassy seizure achieved what the revolution itself had not[1] – an immediate and abrupt transformation of the economic relationship between Tehran and Washington. The U.S. policy framework was established in the earliest hours after the embassy staff was taken hostage. As a former senior State Department official recalled, "almost as soon as policy discussions began on [the day after the embassy was overrun], the members of the crisis team in both the White House and the State Department focused on a two-track strategy." The objective then was to "open the door to negotiation" while also "increas[ing] the cost to Iran of holding the hostages." Since then, the U.S. formula for influencing Iran via a combination of pressure and incentives has remained fundamentally intact.

The embrace of a dualistic approach reflected divisions within the Carter administration, between those such as Secretary of State Cyrus Vance, who favored negotiations, and others, including National Security Advisor Zbigniew Brzezinski, pressing for coercive options. However, the military options available in November 1979 – including a rescue mission and retaliatory strikes or raids – did not offer compelling prospects for successfully extracting the captive diplomats. With their safe release as the paramount U.S. policy objective, Washington sought to exhaust nonmilitary measures before resorting to force. Even economic pressure was not universally endorsed, particularly in the Congress, where skepticism toward sanctions as a foreign policy tool ran high, as did concerns about collateral damage to a stagnant American economy.

Still, U.S. efforts to persuade Tehran to release the hostages ultimately relied heavily on economic pressure: prohibitions on U.S. imports of Iranian oil, a freeze of all Iranian state assets held by U.S. institutions, and eventually a travel ban and a comprehensive embargo on nearly all forms of trade. Even here, the Carter administration opted for incrementalism, anxious to avoid endangering the hostages or further entrenching Iran's revolutionary paranoia. For this reason, the sole measures undertaken in the immediate aftermath of the embassy seizure were the ban on importing Iranian oil and the assets freeze. The uncertainties surrounding Tehran's prospective reactions to U.S. measures

[1] Iran's non-oil exports to the U.S. actually increased in the months immediately following the revolution. Mehrdad Valibeigi, "U.S. Iranian Trade Relations after the Revolution," p. 212

or corporations, in contrast to other similar cases, a measure that protected the sizable and relatively well-off Iranian-American community. However, Washington's decision to apply the measure to Iranian assets held in other countries proved powerful and foreshadowed persistent American efforts to extend U.S. sanctions' writ to third countries. Tehran responded in kind to the economic measures unveiled in the early weeks after the hostage seizure, largely through efforts to boycott the dollar and other measures intended to undermine the stability of U.S. currency.

The deployment of economic pressure against Tehran was facilitated by the fact that some bureaucratic groundwork had already been accomplished. The shah's initial ouster had already prompted U.S. government contingency planning, and the private sector undertook similar efforts to hedge its exposure vis-à-vis Iran. Some analyses have suggested that American policy toward Tehran during this period was unduly influenced by U.S. banking interests, but these allegations have not been borne out by impartial investigation, and it is apparent that the Iranians themselves did not put much stock in such purported intrigue, which Rafsanjani described after the fact as "not correct." Predictably, Tehran instead favored a broader conspiracy, as Rafsanjani confirms: "Our view was that they admitted the Shah to America to use him as a plot against us."[8]

The array of stakeholders and the complexity of the legal, financial, and political issues at stake complicated Washington's options. Some American firms had already taken legal action against Iran over business disputes, and there was some ambiguity about whether Carter's decision to freeze all Iranian assets took precedence over judgments already awarded or in process.[9] However, the multiplicity of interests and parties in this opening installment of the U.S.-Iranian estrangement contributed to a resolution of the hostage crisis. For example, representatives of several American banks remained in regular contact with designated mediators for Iran's Central Bank governor and finance minister throughout much of the standoff. This dialogue was separate from the various channels that eventually led to the final resolution, although the U.S. government was fully informed of its details.[10] The bankers' and lawyers'

[8] *Iqtisad-i Siysasi-i jumhuriya Islami*, pp. 58–9.

[9] Kate Gillespie, "US Corporations and Iran at The Hague," *Middle East Journal* 44:1 (1990), p. 21.

[10] John E. Hoffman, Jr., who was the lead counsel for Citibank at the time, writes that "I was never told what other lines of negotiation were open, and it was not until the government negotiations through the Algerians had commenced and were reported upon

exhaustive discussions over the assets freeze and other outstanding bilateral financial claims helped facilitate the eventual agreement once a political commitment to a resolution had been achieved on both sides. As one of the negotiators of that agreement has argued, the vast and complex financial claims between the two countries, many involving private disputes stemming from the revolution, would have effectively obligated both sides to engage in negotiations even if no political imperative for doing so had existed.

As suggested in Chapter 3, this crisis offers a striking example of sanctions' efficacy in producing demonstrable Iranian concessions, as well as in establishing an ongoing constructive vehicle for conflict mediation (the U.S.-Iran Claims Tribunal). However, the episode also underscores the limitations of economic pressures as a tool of influencing Iranian policy and highlights the difficulty in achieving multilateral support for penalizing Iran. Despite broad sympathy with Washington and outrage over the affront to international law and diplomatic protocol, even America's closest international partners proved reluctant to jeopardize their economic interests with Iran or undertake measures that might alienate opinion elsewhere in the Muslim world. The Carter administration galvanized support for United Nations Security Council Resolutions 457 and 461, which exhorted Iranian cooperation. However, the resolutions did not require sanctions and specifically excluded purchases of Iranian oil from proposed measures. And Soviet opposition, aided by Iranian negotiating ploys, torpedoed a successor resolution mandating sanctions.

The diplomatic discord enabled Iran's trade partners – countries that also happened to be close U.S. allies – to sustain business as usual for many months. Initially, the Carter administration made relatively minimal demands for allied action, instead seeking support in accessing the hostages and mitigating fallout from the assets freeze. However, even these requests caused frictions, and they intensified as Washington embraced the need for a comprehensive embargo on Iran. In initial consultations, Europe and Japan promised "virtually universal support," but in practice these governments took no steps except to delay some military sales.[11] In fact, their actions contradicted their pledges of

publicly that I was much aware of activities beyond those in which I was personally involved," Hoffman, "The Bankers' Channel," in Christopher et al. (1985), pp. 251–2.

[11] Paul Lewis, "U.S. Urges Iran Sanctions, But Whom Will They Hurt?" *New York Times*, December 16, 1979, p. E2.

crude helped Tehran to manage the disruption with Washington and balance production with demand. This too offered a political payoff, by enabling Iran's revolutionary leadership to trumpet the failure of U.S. efforts to isolate the new government.[25] All told, these tactics helped entrench Iranian skepticism toward sanctions.

The deliberations over sanctions during the hostage crisis reflected a persistent overconfidence among U.S. officials about American capacity to impact Iran's ferocious power struggle in a positive fashion. Then as now, U.S. officials sought to craft a balance of inducements and penalties that would empower the theocracy's persistently embattled moderates. It is difficult to discern any meaningfully constructive influence that carrot-and-stick diplomacy had on the balance of power within the Islamic Republic.

As discussed in Chapters 3 and 4, Iranian officials repeatedly spurned the notion that their decisions on the handling of the hostages would be influenced by the American sanctions. American officials understandably saw the situation very differently; while the lead negotiator Warren Christopher acknowledged that Tehran might have achieved some "psychic satisfaction that outweighed the tangible disadvantages, at least for a time and at least in the minds of the most radical elements," he expressed confidence that no "nation would find such a psychic ride to be enough compensation for the massive losses Iran suffered."[26] This would not be the last time that Washington and Tehran would use very different standards of accounting to assess the relative utility of U.S. actions in altering Iranian policies. These tactics served their purpose and helped entrench Iranian skepticism toward sanctions.

The U.S.-Iran Claims Tribunal – and the intragovernmental agreement that established it – withstood early tests of its viability and credibility, including a somewhat predictable Iranian bid to revise the tribunal's mandate in Tehran's favor.[27] It saw a slow start (only 387 claims were settled by 1987), punctuated by periodic outbursts, including a 1984 assault by the Iranian judges against an independent arbiter.[28] However, over the course of the subsequent years, the tribunal managed

[25] *AFP*, "Iranians report China oil deal,"

[26] Warren Christopher, "Introduction," in Christopher et al. (1985), p. 14.

[27] Iran sought to introduce lawsuits by the government against U.S. firms, which was explicitly excluded under the terms of the Algiers Accords. When its bid was rejected, Tehran had to withdraw 1,400 claims from the purview of the Tribunal. See Gillespie (1990), pp. 22–3.

[28] Gillespie (1990), p. 26.

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Saddam in 1981, the Iranian Embassy in Paris declared that "the Iranian people will never forget this act" and French exports to Iran declined by 40 percent in 1982.[37] Similar dramas played on several subsequent occasions, as Paris opted to provide its Iraqi ally with advanced technology and weaponry and Tehran responded with threats to shut down Gulf oil exports. In 1983, Tehran severed commercial and banking ties with France and cut off oil supplies, which had risen to 6 percent of French imports in the previous year. In late 1986, Paris and Tehran settled a $1 billion dispute over loans made by the shah to the European enriched uranium facility Eurodif, and within days several Western hostages including two French citizens were released.

For the most part, Iran's new authorities tended to favor countries that did not have a deep relationship with the shah or strong ties with the West – primarily Eastern and Central European states, Turkey, and Asia. Courting regional powers and outcasts without close affiliation with Washington and underpinning these diplomatic relationships with tangible economic benefits helped Tehran to mitigate the restrictions it faced, including some self-imposed. This strategy proved attractive to a number of states. Turkish exports to the Islamic Republic increased sixfold between 1980 and 1982, and in 1982 Ankara and Tehran signed a trade agreement that helped boost trade further.

That same year, Tehran sent a trade delegation to Brazil in hopes of reviving the prerevolutionary trade relationship. Part of Iran's sales pitch involved promising Brasilia a major role in the eventual postwar reconstruction. The pitch succeeded; Brazilian officials opted to shift their oil purchases away from Baghdad, as an official explained, because "Iran has 40 million people, it has oil and it is going to win the war."[38] This presumption helped persuade even Iran's adversaries to get in on the action. Besides the Iran-contra episode, dealt with in depth in Chapter 4, Israel bought $36 million in Iranian oil in 1989 in hopes of encouraging Tehran to facilitate the release of three Israeli soldiers held captive in Lebanon.[39] And Australia and New Zealand took advantage of the American departure by expanding their food and agricultural exports to Iran.

[37] Milt Freudenheim and Barbara Slavin, "A Bombing Run down Memory Lane," *New York Times*, February 8, 1981; David Housego, "Tehran Retaliates for Jet Sale to Iraq," *FT*, November 11, 1983.

[38] Andrew Whitley, "Brazil Drops Iraq in Favor of Iran," *FT*, May 17, 1982.

[39] "Israel-Iran Oil Deal Disclosed and Tied to Captives," *New York Times*, December 20, 1989, p. A3.

An examination of long-term trends in Iran's international economic relations suggests that the Islamic Republic's turn toward the East intensified during the war with Iraq. Tehran's efforts to replace American products and services were sourced to states in Southeast Asia, such as Thailand and Indonesia. And Iran resumed imports of Toyota vehicles in mid-1981, after initially rescinding contracts in an effort to boost domestic auto production. Finally, China emerged as a vital source of armaments and materiel – particularly missiles and missile technology. Sino-Iranian trade beyond weapons or energy also began to reemerge in the 1980s, with projects including dam construction and fishery development, as well as the establishment of a Joint Committee for Trade, Science, and Technology Cooperation in 1985 to identify investment projects and participating firms.[40]

Still, trading with a revolutionary state engaged in a total war was hardly an easy proposition. The initial postrevolutionary trade regime was skewed and highly state-controlled. Iran's revolutionaries cancelled a wide range of contracts and major foreign investment projects. In theory, at least, luxury goods were to be eschewed and imports were to be discouraged as Iranian leaders extolled the virtues of national self-sufficiency. An elaborate procurement system was established, under the auspices of the Ministry of Commerce, requiring prospective importers to work through one of eleven different sectorally organized centers. Moreover, even those European states that managed to maintain trade ties with the Islamic Republic found that they were forced to contend with episodic crises and wild oscillations in the tenor of relations. Britain was plagued by a series of "diplomatic contretemps,"[41] which included a 1986 clash over the British refusal to accredit an Iranian diplomat because of his involvement in the U.S. Embassy seizure and the 1987 arrest of an Iranian consular officer in Manchester on shoplifting charges, which sparked the armed seizure and beating of a British diplomat in Tehran and a series of expulsions and reprisals that practically emptied the embassies on both sides. A thorny rapprochement with France was quickly scuttled over French suspicions of Iranian involvement in terrorist bombings the year earlier. Even Germany, which was at the time one of Iran's leading trade partners, found itself the subject of official Iranian recriminations and retribution in 1987,

[40] Garver (2006), p. 242.

[41] Cameron R. Hume, *United Nations, Iran and Iraq: How Peacemaking Changed* (Bloomington: Indiana University Press, 1994), p. 66.

consensus, presumably galvanized by shared concerns about destabilization of the Gulf as well as a desire to insulate its Iraqi ally.

Even as Washington sought to use sanctions to force Tehran to end its campaign in Iraq, the Reagan administration began to embrace new unilateral measures against Iran that were unrelated to the status of the conflict itself. In 1987, Tehran was named a major narcotics producing state, a declaration that merely duplicated the penalties associated with the terrorism list. The same year also saw the reimposition of an American embargo on Iran. The administration was initially split on this step. Traditionally, Washington preferred to maintain low trade levels with Iran, because trade offered a potential source of information on and influence within the Iranian private sector and because, as one State Department official acknowledged in 1987, "it's so minimal right now that there is no effective purpose in reducing it."[49]

As direct military engagements in the Gulf escalated, Congress and the Pentagon pushed hard for a comprehensive trade and investment ban. Initially, opposition from the Commerce and State Departments scuttled any movement, but the underlying impetus for increasing pressure on Tehran remained strong. Reagan's hesitation reflected a hard-won realism about the limited impact of any U.S. oil embargo on Tehran, and about the impact of new U.S. sanctions on Washington's push for a multilateral arms embargo against Tehran and the residual activities of the bilateral claims tribunal.[50] In addition, his use of sanctions against the Soviet Union, Nicaragua, and Libya had generated little more than diplomatic headaches and had imposed higher costs on U.S. companies than on their ostensible targets. Still, the political imperatives were undeniable; the tempo of Iranian attacks on Gulf shipping simply made any kind of normal trade, particularly in a strategic commodity such as energy, indefensible. John Herrington, Reagan's energy secretary, welcomed the congressional action, arguing that "the American people would rather walk than buy Iranian oil," and "we do not want to support the Iranian war effort."[51]

Reports of increasing Iranian imports to the United States sparked renewed congressional activism in Congress. U.S. imports from Iran were surging, largely as a result of increased oil purchases to hedge against

[49] Elaine Sciolino, "U.S. Officials Called Bitterly Split Over Continuing Trade with Iran," *New York Times*, June 22, 1987, p. A1.

[50] Elaine Sciolino, "Iran Embargo: The Main Import Is Political," *New York Times*, October 11, 1987.

[51] "Herrington Supports Boycott," *New York Times*, October 7, 1987.

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Iran. The inconsistencies in the 1987 embargo meant that U.S. oil companies continued to purchase large quantities of Iranian crude without violating any legal restrictions so long as they refined the crude and sold the products elsewhere. American firms were purchasing as much as 25 percent of Iran's exports by 1994 – more than any other state. For their part, the Iranians reveled in highlighting this discrepancy, presumably intended to undercut American pressure on Europe. Iran's Central Bank governor went on record asserting that American companies had exported $1 billion Iranian goods and suggested that U.S. efforts to persuade Europe to join the embargo were a competitive move aimed at eliminating rivals for the Iranian marketplace.[64] The disparity between Washington's advocacy and the behavior of American companies emerged as a political embarrassment and a tactical problem. In a joint press conference with President Clinton at the White House in February 1995, German Chancellor Helmut Kohl pointedly referenced reports on the large stakes of U.S. oil companies in Iran's export revenues.[65]

Washington began to focus on strengthening restrictions on U.S. companies as a means of persuading American allies to take its concerns about Iran more seriously. However, even within the U.S. government, there was no unanimity of views. In 1994, various U.S. agencies disagreed over a proposed sale of Boeing 747s to Tehran, with Commerce, Treasury, and even some Pentagon officials advocating its approval. State Department opposition killed the deal, in part by persuading the Saudis to condition a $6 billion aircraft purchase on the willingness of American aerospace firms to forgo the Iranian opportunity. The availability of alternative supplies – in this case, Airbus – meant that the move achieved little in imposing real costs on Tehran.

Torpedoing the Boeing sale was the first in what became an activist U.S. government agenda of sanctioning Iran and seeking to degrade its access to

[64] "Iran's Central Bank Says U.S. Imported $1B in Iran Goods," *Dow Jones News Service*, January 12, 1994.

[65] Kohl commented: "As far as Iran specifically is concerned, we are in agreement. We are not willing to support any policy in Iran which might entail the danger of fundamentalism, which to me is one of the greatest dangers we are facing today. We are not willing to add any support to fundamentalism. We have cut back economic relations with Iran considerably. Those were longstanding relations which we have cut back considerably. And if I'm not mistaken, Time Magazine being a respectable news magazine, has said quite a number of things this week about American oil companies, not German oil companies, mind you. And if you take a look, you'll have to conclude that these oil companies export into other countries, not our country." Transcript of Clinton-Kohl Press Conference (part 1 of 3), *U.S. Newswire*, February 9, 1995.

international trade and finance. In what would become institutionalized features of American foreign policy, Washington adopted a multipronged approach to economic pressure and weighed in with all its allies and partners to use moral suasion as a means of eroding international interest in economic opportunities in, and diplomatic dialogue with, Tehran. The Clinton administration track record in this regard is extensive, even outside the energy sector: Washington undermined Iranian efforts to reschedule debts, blocked loans by the World Bank and International Monetary Fund, reversed Japanese plans for a several hundred million dollar aid project in southern Iran, swayed Moscow to restrict its arms sales to defensive weaponry, and otherwise increased the costs and inconvenience to the Iranian economy at a time when Iran was still struggling to recover from the war and the aftereffects of revolutionary turmoil and mismanagement. American opposition helped constrain flows of capital into an Iran in flux. Even with the more outward-looking policies championed by Rafsanjani and, later, Khatami, the return of foreign direct investment (FDI) to Iran was slow throughout the 1990s. By the end of 2001, the stock of FDI had only rebounded to $2.492 billion.[66] Through this period, Iran's FDI compared to that of neighboring nations was abysmal – in 2001, Iran accounted for only 0.34 percent of all FDI inflows into the broader Middle East and North Africa region.[67]

As part of its efforts to cordon off Iran from the rest of the region, the Clinton administration also adopted a vigorous agenda on Central Asian energy. Officially, U.S. policy sought to promote multiple pipelines; unofficially, Washington sought to preclude Iran (and Russia) from participation in the newly developing energy linkages of the post-Soviet space. The capstone of this policy was official American advocacy for the $4 billion Baku-Tblisi-Ceyhan pipeline, which was formally committed in 1999 and officially launched in 2005. Unlike the thwarted Boeing deal, these policies did more than simply advantage a competitor – in this case, Turkey; they deprived Iran of a central role as the transit route for Central Asian and Caucasian energy supplies.

Still, pressure built within Washington for more aggressive action against Iran's slowly reviving trade and investment ties with the world,

[66] UNCTAD. FDIStat Database, Major FDI Indicators, http://stats.unctad.org/FDI/TableViewer/tableView.aspx?ReportId=1254.

[67] Massoud Karshenas and Hassan Hakimian. "Managing Oil Resources and Economic Diversification in Iran." In Katouzian and Shahidi (eds.), *Iran in the 21st Century: Politics, Economics, and Conflict* (London: Routledge, 2008), p. 197.

particularly among Republican leaders in the Congress. Led by Speaker of the House Newt Gingrich (R-GA) and Senator Alphonse d'Amato (R-NY), proposals for a wholesale embargo circulated Congress. The executive branch restrained these initiatives, arguing instead for targeted multilateral measures focused on arms transfers, dual-use technology, and the extension of official government credits and other financial support to Tehran. However, in March 1995, events conspired to put the administration on the hot seat. Tehran's award of its first upstream oil deal since the revolution to an American company sparked a firestorm and left the administration scrambling to denounce the deal while grudgingly acknowledging its permissibility under existing U.S. law. The deal immediately elicited passionate denunciations from every corner of Washington, including from Secretary of State Warren Christopher, who proclaimed, "wherever you look, you find the evil hand of Iran in this region," shortly before he recused himself because of a conflict of interest involving his previous law firm.[68]

Within a week, board members of Conoco's parent company, E. I. du Pont de Nemours & Company, had declared their objections, and Clinton announced that he would issue an executive order banning U.S. companies from financing, management, or development activities in Iran's energy sector. A second executive order two months later extended the embargo to all trade, financial, and commercial transactions involving U.S. firms and their overseas subsidiaries.[69] Clinton scorned the proposition that trade could positively influence Tehran's policies, noting that

> many people have argued passionately that the best route to changing Iranian behavior is by engaging the country. Unfortunately, there is no evidence to support that argument. Indeed, the evidence of the last two years suggests exactly the reverse. Iran's appetite for acquiring and developing nuclear weapons and the missiles to deliver them has only grown larger. Even as prospects for the peace in the Middle East have grown, Iran has broadened its role as an inspiration and paymaster to terrorists. There is nothing to suggest that further engagement will alter that course.[70]

[68] "Christopher Attacks Conoco Oil Deal with Iran," *Reuters*, March 9, 1995.

[69] Executive Order 12957, signed on March 15, 1995, prohibits U.S. companies from investing in Iran's energy sector, http://www.treasury.gov/resource-center/sanctions/Documents/12957.pdf. E.O. 12959, which extends U.S. sanctions to a wide-ranging ban on all exports of goods and services to Iran as well as investment, was signed on May 6, 1995, http://nodis3.gsfc.nasa.gov/displayEO.cfm?id=EO_12959_.

[70] Todd S. Purdham, "Clinton to Order a Trade Embargo against Iran," *New York Times*, May 1, 1995.

well. And their utilization helped inform a more aggressive approach to pursuing the financial dimensions of international terrorism. The campaign to constrain and penalize Al Qaeda served as a model, one that arguably proved even more effective when applied to a state actor such as Iran with manifold interconnections to the international financial system.

The primary weapon in this new initiative was Executive Order 13224, a measure signed by President Bush a mere two weeks after the 9/11 attacks. E.O. 13224 freezes all assets of individuals and organizations designated as terrorists,[83] and in concert with other early measures, such as the October 2001 USA Patriot Act, proved "a powerful and flexible tool" by extending the reach of the U.S. Treasury Department's existing investigatory and punitive mechanisms.[84] Interestingly, although a number of Iranian-affiliated groups such as Hezbollah and Palestine Islamic Jihad were included on the initial list of sanctioned entities, the first Iranian group to be incorporated in the Treasury Department's E.O. 13224 designations was the Mojahideen-e Khalq. This designation was consistent with its inclusion on the State Department's list of foreign terrorist organizations, but it also may have served as a reward for the initial bout of cooperation between Tehran and Washington in the Afghan dimensions of the American war against terrorism.

It took four additional years, and the intensification of the standoff between Washington and Tehran over the nuclear program, before the new authorities were applied squarely to Iran. In the meantime, the bilateral relationship remained characterized by striking contradictions. Between 2001 and 2003, the Bush administration engaged in the most substantive direct dialogue with Iranian officials since the conclusion of the Algiers Accords, a process that facilitated unprecedented cooperation between the two adversaries in and on Afghanistan. However, even as these talks were under way, U.S. policy toward Tehran was hardening significantly; in January 2002, President Bush described Iran as part of an "axis of evil," and later that year revelations about Iran's covert nuclear activities put the two countries on a collision course in which economic pressure would increasingly assume a central place in Washington's strategy. Still, for most of Bush's first term, U.S. policy in the region remained

[83] The text of E.O. 13224, signed in September 200, is available at http://www.treasury.gov/resource-center/sanctions/Programs/Documents/terror.pdf

[84] Testimony bfore the Senate Committee on Banking, Housing and Urban Affairs, by Adam J. Szubin, Director of the Office of Foreign Assets Control, U.S. Department of the Treasury, September 12, 2006.

focused on Iraq, rather than Iran, with the expectation that Saddam Hussein's successful ouster would ultimately create the conditions for positive change within Iran.

Although Washington began to articulate a more absolutist approach to Iran than it had at any time since the hostage crisis, the administration sought to influence Iran through means other than sanctions. For most of the first Bush term, there were no serious efforts to intensify economic pressure, in part as a result of competing priorities as the war on terror and the Iraq campaign consumed senior policy maker attention. Moreover, within the administration and between Washington and its closest allies, Iran policy was subject to ambiguity. Hawks pushed for more aggressive penalties against Tehran and more explicit regime change efforts, tactics that concerned America's European allies, while administration moderates advocated expanded engagement with the clerical regime.

As a result, U.S. Iran policy during the early Bush administration was characterized by rhetorical excess and programmatic neglect. The administration presumed that the ouster of Saddam and the establishment of a pro-Western, democratic Iraq would undercut the legitimacy of Iran's Islamic Republic. On this basis, Washington abandoned nascent dialogue with Tehran on Afghanistan, and unofficial Iranian overtures, including an expansive proposal for a "grand bargain" proffered by the Swiss ambassador to Tehran with the input of several Iranian diplomats, were disregarded. For similar reasons, the Bush administration initially resisted European diplomacy on the nuclear issue. As the dispute became entrenched and Iraq erupted into civil war, U.S. officials accepted that a direct American role in that dialogue would offer greater leverage in dealing with the issue. In an attempt to provide incentives for Iranian cooperation on the nuclear talks, in May 2005, Washington dropped its objections to Iran's application to begin accession talks with the World Trade Organization and announced that it would consider licensing sales of spare parts for aircraft on a case-by-case basis.

Over time, as circumstances produced little evidence of positive change within Iran and the situation in Iraq created new bilateral tensions, Washington sought to alter the calculus of the Iranian leadership through the application of additional pressure. The first step occurred after Tehran's decision to abandon its commitment to suspend uranium enrichment and reprocessing. The August 2005 removal of the seals at the Natanz enrichment facility intensified Washington's attempts to expand the existing counterproliferation measures, with the application of a model crafted around the antiterrorism authorities. Such designations

freeze any U.S.-based assets and preclude any American individual or institution from engaging in any transactions with them. This prohibition extended to the exceptionally tangential contacts that characterize the movement of capital in the modern international financial system, including what are referred to as "U-turn" transactions, which entail only indirect interaction involving a third-party bank or financial institution. The scope and reach of the U.S. financial system mean that such measures effectively blacklist the designated institutions from any contact with any individual or institution with U.S. business interests, and as such have a powerful extraterritorial dimension. President Bush signed Executive Order 13382 in June 2005 and designated Iran's Atomic Energy Organization, Aerospace Industries Organization, the Shahid Hemmat Industrial Group, and Shahid Bakeri Industrial Group under its authority.[85]

The real innovation, however, was in September 2006, when the U.S. Treasury Department for the first time designated an Iranian financial institution – Bank-e Saderat – as well as Iran's Qods Force under EO 13224 on the basis of their funds transfers to Hezbollah. The move prompted banks around the world to curtail transactions with Saderat, and the ripple effect encouraged Washington to strike again. One by one, Iranian banks were designated under the antiterrorism and counterproliferation authorities: Bank-e Sepah in January 2007, Bank-e Melli and Bank-e Mellat in October 2007, and eventually nearly all Iranian financial institutions. Along with the banks, the Bush administration sought to target Iran's security organizations, to hamper further their resources but also to underscore – as had the Clinton administration – that Washington's real differences lay with Iran's hard-liners rather than with its population. In addition, a series of official and semigovernmental institutions were listed alongside the banks and the military, including the Martyrs' Foundation, Al Qarz Al Hassan, and Khatam Al-Anbia and other IRGC-controlled companies.

Washington also unleashed a powerful public relations campaign aimed squarely at the compliance departments of financial institutions in Europe, Asia, and the Gulf, intended to highlight both the increasing legal roadblocks as well as the reputational risks of investing in Iran. Treasury Department officials described such moral suasion as a "force multiplier," noting that "financial institutions may do so because

[85] The text of E.O. 13382, signed in June 2005, is available at http://www.treasury.gov/resource-center/sanctions/Programs/Documents/wmd.pdf

his original support was predicated upon the belief that "there are signs that some Iranians understand the impact their regime's behavior is having on Iran's national interests.... We should send a message that, if Iran wishes to benefit from the international system, it must play by international rules. If it chooses to flout those rules, then the world will turn its back on Iran."[91]

Obama's approach to Iran retained the basic framework of the Bush approach; however, he succeeded in enhancing the persuasive power of U.S. policy – initiating early overtures toward Tehran as a means of demonstrating to Europe the seriousness of American readiness, making key compromises on issues at stake with Russia to draw Moscow into a more cooperative relationship on Iran, and investing in a protracted negotiation of the fourth UN resolution on Iran, Security Council Resolution 1929, so that it would serve as a platform for additional measures by individual states as well as the European Union.

The advantages of this synergy cannot be underestimated, and in many ways those subsequent unilateral sanctions are far more significant than the UN measure itself. Washington took other steps to encourage cooperation among "like-minded states" in Europe and in Asia, notably by utilizing sanctions policy to highlight human rights abuses in Iran and to restrict the government's access to technology used to control the free flow of information. These include the following:

- 2010 American[92] and European sanctions[93] that targeted Iran's imports of refined petroleum products and new energy investments, respectively
- 2011 U.S. measures targeting investment in or support to Iran's petrochemicals industry,[94] a step taken in tandem with a British move to sever all financial relations with Iran, including with the Central Bank.[95]

[91] THOMAS.loc.gov.;
H.R. 2347, 110th Congress: The Iran Sanctions Enabling Act of 2007
Congressional Record, Senate, May 17, 2009, p. S6309
AIPAC, "Bill Summary: Iran Sanctions Enabling Act of 2007 – H.R. 2347." July 31, 2007, available at http://www.aipac.org/Publications/AIPACAnalysesBillSummaries/Bill_Summary_HR_2347.pdf

[92] Text available at http://www.treasury.gov/resource-center/sanctions/Documents/hr2194.pdf

[93] Text available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:281:0001:0077:EN:PDF

[94] Text of E.O. 13590 is available at http://www.treasury.gov/resource-center/sanctions/Documents/13590.pdf

[95] Text of UK decision available at http://www.fco.gov.uk/en/news/latest-news/?view=News&id=695250182

- 2011 and 2013 measures imposed by the United States and the European Union targeting Iran's Central Bank,[96] its crude exports to Europe, and its access to European-based insurance services,[97] as well as other vital links to the international financial system.

In addition, European leaders joined, with varying degrees of enthusiasm, in the American-led effort to use moral suasion to reduce foreign investment in Iran. As a senior German official warned, "The company leaders should consider whether new deals with Iran are truly appropriate." On this basis, companies including Deutsche Bank and E.on-Ruhrgas were persuaded to forgo prospective opportunities in Iran, and worldwide more than eighty banks cut off interactions with their Iranian counterparts. However, some businesses recoiled at the notion that company/shareholder interests in seeking investment returns should be constrained without legal justification. "We cannot restrict business simply because a politician promises it," a businessman responded. "On what legal grounds should that then happen?"[98]

During Obama's presidency, American sanctions went through several stepwise changes in intensity. The first occurred in June and July 2010, with UN Security Council Resolution 1929 and the Comprehensive Iran Sanctions and Divestment Act (CISADA). The UN resolution represented a major victory for the administration, one that was hard-fought and required months of painstaking diplomacy with Europe, Moscow, and eventually Beijing.

CISADA represented a revamped and superpowered version of the former Iran-Libya Sanctions Act. The final law included a rescission of the prior exemption of caviar, carpets, and pistachios from U.S. sanctions, as well as a new array of extraterritorial measures including restrictions on sales of refined petroleum products to Tehran. In part because CISADA was enacted so quickly on the heels of the UN resolution, there was some grumbling, particularly from the Russians, that Washington

[96] The Central Bank measures were imposed via the National Defense Authorization Act, signed by President Obama on December 31, 2011 and text available at http://www.gpo.gov/fdsys/pkg/PLAW-112publ81/pdf/PLAW-112publ81.pdf, and a follow-up executive order (E.O. 13599) signed in February 2012 that freezes all assets of the Central Bank in the United States, http://www.gpo.gov/fdsys/pkg/FR-2012-02-08/pdf/2012-3097.pdf

[97] Text available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:019:0022:0030:EN:PDF

[98] Beat Balzli, Konstantin von Hammerstein, Christian Reiermann and Wolfgang Reuter, "New Confusion: Tougher Iran Sanctions Could Backfire on Germany If Teheran Halts Debt Repayment," *Der Spiegel*, Sunday, November 18, 2007.

Still, as Beijing calibrated its trade with Tehran in order to prevent frictions with Washington – "a strategy of opportunistic pragmatism in that they have sought to placate both US and Iranian concerns to maximize gains from both parties"[102] – Iranians began to perceive that they had once again become pawns in a great power rivalry. Analysts from both sides of the political spectrum cautioned that Beijing's economic interests in Iran will not trump its strategic relationship with Washington, or even its energy relationships with the Saudis or other competitors.

In response to American efforts to craft a consensus around new multilateral pressures on Iran, Beijing typically engaged in passive efforts to slow the process or blunt the impact of the measures themselves. However, China has taken care to ensure that its posture within Iran does not expand at a time when the rest of the world is departing. In late 2007, Iranian businesses complained about Chinese refusal to extend letters of credit needed to maintain trade ties,[103] and Tehran has cancelled several of the contracts awarded to Chinese companies in the oil and gas sector because of lack of progress.

These measures, and the general frustration with the degeneration of the business climate in Iran, presented a dire set of circumstances for Iran's energy business just at the moment at which its gas development had begun to take off. Major IOCs including Shell and Repsol walked away from signed deals for South Pars projects. Most other Western companies, including firms that were early entrants to Tehran's reopened energy sector such as Total, Statoil, and ENI, foreswore new opportunities in Iran, closing their offices in Iran and curtailing future prospects there. The major construction firms that had fabricated facilities and transportation networks associated with Iran's petroleum sector scaled back, or withdrew completely, and the European and Asian banks that provided much of the capital for several early phases of South Pars as well as a number of other upstream projects left. Ultimately, Tehran announced that all future development of South Pars would remain in the hands of Iranian firms, a face-saving attempt and tacit recognition of the country's return to isolation.

of imperialism – but ultimately emerging victorious over the western powers – were nearly identical at many high-level meetings both before and after the Islamic Revolution in spite of the drastic regime change that it brought. Garver (2006), p. 10.

102 Nicolo Nourafchan, "Constructive Partner or Menacing Threat? Analyzing China's Role in the Iranian Nuclear Program," *Asian Security* 6:1 (2010).

103 Nazila Fathi, "Iran hails U.S. report that it halted bid for nuclear arms," *New York Times*, December 5, 2007.

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